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No. 93-

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

NCR CORPORATION,
Petitioner,
v.
TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO,
Respondent.

Petition for a Writ of Certiorari to the Court of Appeals of New Mexico

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the prohibition of the Foreign Commerce Clause against state taxes that inevitably cause international multiple taxation precludes a state from taxing a corporation's foreign source dividends, interest, and royalties on which the corporation has already paid taxes on an unapportioned basis to foreign countries.

2. Whether the fair apportionment requirement of the Commerce and Due Process Clauses precludes a state from including in a corporation's apportionable tax base income received from its unitary subsidiaries without taking account of the subsidiaries' income-producing factors in the apportionment formula.

RULE 29.1 STATEMENT

Petitioner NCR Corporation is a wholly-owned subsidiary of American Telephone & Telegraph Company, which itself has no parent corporation. Petitioner's subsidiaries, other than wholly-owned subsidiaries, are as follows:

NCR Ghana Limited

NCR Japan, Ltd.

NCR (Nigeria) Limited

NCR (Thailand) Ltd.

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PETITION FOR A WRIT OF CERTIORARI

NCR Corporation respectfully petitions for a writ of certiorari to review the judgment of the Court of Appeals of New Mexico in this case.

OPINIONS BELOW

The opinion of the Court of Appeals of New Mexico (App. A at 1a-8a) is reported at — N.M. —, 856 P.2d 982. The opinion of the Taxation and Revenue Department of the State of New Mexico (App. B at 19a-69a) is unreported.

JURISDICTION

The judgment of the Court of Appeals of New Mexico was entered on May 6, 1993. The Supreme Court of the State of New Mexico denied NCR's petition for cer-

tiorari on July 8, 1993. App. C at 70a. The jurisdiction of this Court rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution, U.S. Const., art. I, § 8, cl. 3, provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The Due Process Clause of the Fourteenth Amendment of the United States Constitution, U.S. Const., amend. XIV, § 1, provides: "No State shall . . . deprive any person of life, liberty, or property, without due process of law."

Relevant portions of the New Mexico statutes are set forth at App. D at 71a-74a.

STATEMENT

This case raises two issues of great significance for state taxation of multistate and multinational corporations. Both issues arise out of the fact that New Mexico, like most other states, includes in a corporation's apportionable tax base income the corporation receives from its unitary foreign subsidiaries, but does not include the foreign subsidiaries' income-producing factors in the formula used to apportion such income. When, as in this case, the income is received in the form of dividends, interest, and royalties from foreign subsidiaries, and the recipient has already been taxed on that income by foreign countries on an unapportioned basis, the state's failure to provide for "factor representation" of the subsidiaries' factors in the parent's apportionment formula inexorably leads to international multiple taxation. The result is difficult to square with this Court's Foreign Commerce Clause jurisprudence barring state taxes that "inevitably"

cause international multiple taxation. *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434, 447 (1979).

The state's failure to provide for "factor representation" also raises a critical issue under the Court's "domestic" Commerce and Due Process Clause jurisprudence. In *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425 (1980), the Court explicitly left open the question whether the inclusion of dividend income from unitary subsidiaries in the parent's apportionable tax base requires that the subsidiaries' factors be reflected in the parent's apportionment formula. *Id.* at 441 n.15. Justice Stevens, who did address this question, observed that unless the subsidiaries' factors were reflected in the taxpayer-parent's apportionment formula, "the inclusion of earnings attributable to those corporations . . . will inevitably cause [the taxpayer-parent's] . . . income to be overstated." *Id.* at 461 (Stevens, J., dissenting) (footnote omitted). This case provides the Court with an opportunity to resolve this issue, which has spawned division and confusion in the state courts.

1. NCR's Business

The facts, which have been stipulated, are not in dispute. Petitioner NCR Corporation is a Maryland corporation with its corporate headquarters and principal place of business in Dayton, Ohio. NCR is engaged in the manufacture and sale of business equipment and machines, including cash registers, automated bank tellers, and computers. During the years at issue (1981-87), NCR conducted business directly in all 50 states and in many foreign countries. In New Mexico, NCR transacted business through the sale of its products and related supplies and services.

In addition to the business that NCR conducted directly within the United States and abroad, NCR conducted business indirectly through domestic and foreign subsidiaries. From an operational perspective, NCR's business was carried on in the same manner, whether

conducted directly by NCR through branches and divisions or indirectly through subsidiaries and whether conducted domestically or internationally. Indeed, it has been stipulated that "[t]he business conducted by NCR Corporation throughout the world, both directly and through its domestic and foreign subsidiaries, is a single, integrated unitary business." Stipulation of Facts ¶ 8 (App. B at 22a-23a).[1]

2. NCR's Dividend, Interest, and Royalty Income Received from Its Unitary Foreign Subsidiaries

NCR had approximately 75 foreign subsidiaries which conducted business in some 150 foreign countries. All but a few of these subsidiaries were wholly owned by NCR. None of them conducted business in New Mexico. From the unitary business carried on with its foreign subsidiaries, NCR derived substantial income in the form of dividends, interest, and royalties. For the years in question, the amounts were as follows:

Year	Dividends	Interest	Royalties
1981	$ 34,416,543	$21,730,821	$ 40,590,222
1982	35,214,185	28,320,913	47,897,917
1983	45,963,133	19,445,024	54,464,120
1984	50,167,524	16,157,574	73,833,474
1985	63,994,155	7,836,796	86,296,270
1986	73,289,419	11,765,099	100,039,780
1987	246,229,126	5,458,622	149,774,394

Stip. ¶ 29 (App. B at 29a-30a).

During the years at issue, NCR paid more than $94 million in income taxes that foreign countries imposed upon NCR on the dividends, interest, and royalties NCR received from its unitary foreign subsidiaries. Stip. ¶ 30

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[1] The Decision and Order of the New Mexico Taxation and Revenue Department adopted the Stipulation of Facts verbatim in its Findings of Fact. App. B at 20a-38a. All references to the Stipulation of Facts are hereinafter denominated "Stip." followed by a paragraph reference.

(App. B at 31a-33a).[2] At the same time, these dividends, interest, and royalties constituted on average more than 62 percent of the income that NCR included in its apportionable New Mexico tax base. Compare Stip. ¶ 29 (App. B at 29a-30a) with Stip. ¶ 33 (App. B at 34a-35a). During the years at issue, New Mexico taxed an apportioned share of these dividends, interest, and royalties. Stip. ¶ 36 (App. B at 36a).

3. New Mexico's Taxing Scheme

New Mexico imposes its corporate income tax upon the "net income" of every domestic corporation and of every foreign corporation doing business in the state. N.M. Stat. Ann. § 7-2A-3(A) (Michie 1978) (1993 Repl.). "Net income" is defined as federal taxable income, as adjusted for New Mexico tax purposes. *Id.* §§ 7-2A-2(C), 7-2A-2(I).[3] For the years at issue, NCR filed returns and paid taxes to New Mexico on a federal consolidated basis in conformity with New Mexico law. *Id.* § 7-2A-8.4; Stip. ¶ 5 (App. B at 21a). Under this filing method, NCR and its domestic subsidiaries—hereinafter collectively and interchangeably referred to as "NCR"—were in substance treated as a single taxpayer.[4] Thus, transactions between members of the domestic consolidated group, such as payments of dividends, interest, and royalties, were effectively eliminated; the domestic group's apportionable income was determined on the basis of its

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[2] These taxes are in addition to the taxes that NCR's foreign subsidiaries paid to foreign countries on their own income. See Stip. ¶¶ 15, 30 (App. B at 25a-26a, 31a-33a). NCR's taxes were typically withheld by NCR's foreign subsidiaries, which paid the taxes to the foreign country on behalf of NCR. Stip. ¶ 15 (App. B at 25a-26a).

[3] None of these adjustments is at issue here.

[4] The tribunals below drew no distinction between NCR and its domestic consolidated group, and no issue in this case turns on that distinction.

transactions with third parties; and the domestic group's combined factors were employed to apportion its income to New Mexico.

Foreign corporations are not included in a federal consolidated return. Consequently, although NCR's relationship to its unitary domestic and foreign subsidiaries was virtually identical, Stip. ¶¶ 7, 8 (App. B at 22a-23a), the foreign subsidiaries were treated quite differently from the domestic subsidiaries for New Mexico income tax purposes. Specifically, there was no consolidation of the foreign subsidiaries' and NCR's operating income from their collective dealings with third parties; the foreign subsidiaries' dividend, interest, and royalty payments to NCR were included in—rather than eliminated from—NCR's apportionable tax base; and, most importantly, the foreign subsidiaries' income-producing factors were not reflected in NCR's apportionment formula.

4. The Assessment

In filing its New Mexico tax returns, NCR excluded from taxable "net income" the dividends, interest, and royalties it received from its foreign subsidiaries. NCR's return position rested on the theory that New Mexico could not include the dividends, interest, and royalties in NCR's apportionable tax base under the Foreign Commerce Clause because such income was subject to tax on an unapportioned basis by foreign countries. New Mexico's taxation of even an apportioned share of such income, NCR maintained, would inevitably lead—and had in fact led—to international multiple taxation in violation of *Japan Line*. In the course of administrative proceedings, NCR took the alternative position that, if the disputed income was apportionable by New Mexico, then, under both the Commerce and Due Process Clauses, the income-producing factors of its foreign subsidiaries should be reflected in the formula employed to apportion the consolidated group's income. The New Mexico Taxa-

tion and Revenue Department (the "Department") rejected these views and assessed NCR for taxes which are currently calculated as $267,036. Stip. ¶ 36 (App. B at 36a).[5]

5. The Decisions Below

NCR timely protested the assessments and renewed its Commerce and Due Process arguments in a formal hearing before the Department. Stip. ¶ 26 (App. B at 27a-28a). The Department recognized that "[i]f *Japan Line* were the Supreme Court's last word on the application of the Foreign Commerce Clause to states' efforts to impose their apportioned income taxes to foreign source income, there would be no need for further analysis . . . ." App. B at 46. Accordingly, "NCR would prevail upon its claim, based upon the fact that it is subject to income taxation on the foreign source income by its foreign host countries as well as in the state of New Mexico, constituting prohibited multiple taxation." *Id.*

The Department nevertheless found *Japan Line* distinguishable from the instant case on the same grounds that this Court had distinguished *Japan Line* in *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983). In *Container*, this Court sustained California's worldwide unitary combined reporting method as applied to a United States multinational corporation over the objection, *inter alia*, that it resulted in multiple international taxation in violation of the strictures of the Foreign Commerce Clause articulated in *Japan Line*. In addressing this claim, the Court in *Container* had observed that "the double taxation in this case, although real, is not the 'inevitabl[e]' result of the California taxing

[5] NCR also raised additional constitutional claims directed specifically to New Mexico's taxation of hypothetical dividend income that NCR was deemed to have received from its controlled foreign corporations under Subpart F of the Internal Revenue Code. I.R.C. §§ 951-964. NCR is not pressing its separate claim with respect to such income in this Court.

scheme." *Container*, 463 U.S. at 188 (quoting *Japan Line*, 441 U.S. at 447). While expressing the view that this Court "in *Container* did not clearly explain the concept of 'inevitability,'" App. B at 49a, the Department nonetheless concluded that there was no "inevitable" multiple taxation in this case because not every foreign country in which NCR earned dividends, interest, and royalties exercised its right to tax such income on an unapportioned basis. *Id.* at 49a-50a.

The Department also rejected NCR's alternative argument that if the income derived from its unitary foreign subsidiaries were included in its apportionable tax base, NCR would be entitled to have the subsidiaries' income-producing factors reflected in its apportionment formula. Noting that this Court had left this issue open in *Mobil*, App. B at 54a, and that NCR's argument was "[a]t first blush, . . . compelling," App. B at 55a, the Department rejected the claim on the ground that NCR had not proved sufficient distortion in New Mexico's apportionment from the failure to include the subsidiaries' factors in NCR's apportionment formula.

The New Mexico Court of Appeals affirmed. App. A at 18a. Like the Department, the Court of Appeals found *Japan Line* inapposite on the theory that "the basic premise and holding of the Court in *Container Corp.* is controlling here." App. A at 9a. The New Mexico court reasoned that this Court's refusal to strike down California's apportioned tax in *Container* justified its own refusal to strike down New Mexico's apportioned tax in the instant case. The court below did not address the differences between the state taxes imposed in *Container* and those imposed in this case. Specifically, it did not consider that California's taxing scheme in *Container* included both the unitary group's operating income in the apportionable tax base as well as the foreign subsidiaries' income-producing factors in the apportionment formula. Instead, the court embraced the view that this case, like *Container*, simply involved application of the principle

that a state need not "give up one method of allocation that may at times result in double taxation in favor of another allocation method that may also result in double taxation." App. A at 7a. Without further explanation, the court observed that in this case, "[u]nlike the situation in *Japan Line*, multiple taxation, although *real*, is not inevitable." *Id.* at 11a (emphasis supplied). The court found *Japan Line* was also distinguishable on the grounds that it involved a property tax rather than an income tax and that the taxpayer there was a foreign rather than a domestic entity. *Id.* at 6a, 8a.

With regard to NCR's alternative argument that it was entitled to have the subsidiaries' factors reflected in its apportionment formula if their dividends, interest, and royalties were included in its apportionable tax base, the court acknowledged that Justice Stevens had advanced this position in his dissent in *Mobil*. App. A at 16a. Although this Court explicitly reserved the question raised by Justice Stevens, *Mobil*, 445 U.S. at 441 n.15; *see also Container*, 463 U.S. at 168 n.5, the court below astonishingly declared that it was "guided by the rationale of the majority decision which *rejected* the views set forth in the dissent" (App. A at 16a) (emphasis supplied). In any event, the court concluded that NCR's contention should be rejected because NCR had failed to demonstrate that the exclusion of the subsidiaries' factors from the apportionment formula had led to a "grossly distorted result." *Id.* at 17a.

REASONS FOR GRANTING THE PETITION

The judgment of the New Mexico Court of Appeals warrants review by this Court for three compelling reasons. First, the court's decision condoning international multiple taxation is incompatible with this Court's Foreign Commerce Clause jurisprudence and, if left undisturbed, would undermine essential restraints on state tax power. At the very least, this Court's guidance is needed to clarify the distinction between taxes that are constitu-

tionally intolerable under *Japan Line* and those that can survive constitutional scrutiny under *Container*. Second, the state court's denial of NCR's right to inclusion of its unitary subsidiaries' factors in its apportionment formula, despite the inclusion in NCR's apportionable tax base of income received from those subsidiaries, disposed of a critical issue that this Court explicitly left open in *Mobil* and that has created a conflict among state courts of last resort. This Court should address that issue and resolve that conflict. Third, the issues of both international multiple taxation and "factor representation" present recurring questions of profound practical importance that merit plenary consideration in their own right.

I. THE STATE COURT'S DECISION CONDONING INTERNATIONAL MULTIPLE TAXATION THAT INEVITABLY RESULTS FROM NEW MEXICO'S TAXING SCHEME CANNOT BE RECONCILED WITH THIS COURT'S FOREIGN COMMERCE CLAUSE JURISPRUDENCE

In *Japan Line*, this Court held that the Foreign Commerce Clause barred a state from imposing a fairly apportioned personal property tax on cargo containers that had been taxed on an unapportioned basis abroad. Although the tax would have passed muster under the Court's Interstate Commerce Clause doctrine, 441 U.S. at 445-46, the Court held that the tax violated the more exacting demands of the Foreign Commerce Clause. Under the Foreign Commerce Clause, "a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation." *Id.* at 451. In addition, a court must determine "whether the tax prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Id.* The Court observed that "[i]f a state tax contravenes *either* of these precepts, it is unconstitutional under the Commerce Clause." *Id.* (emphasis supplied).

As the New Mexico Taxation and Revenue Department conceded—and the Court of Appeals did not disagree—NCR's claim is unassailable if *Japan Line* controls this case: "NCR would prevail . . . based upon the fact that it is subject to income taxation on the foreign source income by its foreign host countries as well as in the state of New Mexico, constituting prohibited multiple taxation." App. B at 46a. Just as Los Angeles County in *Japan Line* sought to subject the taxpayer to an apportioned tax on property that a foreign country had taxed on an unapportioned basis, so, too, in this case New Mexico seeks to subject NCR to an apportioned tax on income that foreign countries have already taxed on an unapportioned basis. Stip. ¶¶ 29-30, 36 (App. B at 29a-33a, 36a).

In an effort to deflect the force of this analogy, the state court relied on *Container*, which concerned California's apportioned income tax on the combined income of a multinational group of corporations. The taxpayer challenged the tax on the ground that, when considered in conjunction with taxes imposed on such income by foreign countries, California's levy subjected the income to international multiple taxation in violation of the Foreign Commerce Clause. In sustaining the tax, this Court found that the international multiple taxation it had condemned in *Japan Line* was constitutionally tolerable in *Container* principally because the double taxation in *Container*, "although real, is not the 'inevitabl[e]' result of the California taxing scheme.'" *Container*, 463 U.S. at 188 (quoting *Japan Line*, 441 U.S. at 447).[6]

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[6] The Court also distinguished *Japan Line* on the ground that the case involved a property tax rather than an income tax and that the taxpayer was foreign rather than domestic. *Id.* at 187-89. But these factors were largely subsumed within the Court's analysis of whether the international multiple taxation in *Container* was "inevitable" and hence intolerable.

The state court's reliance on *Container* is misplaced. The multiple taxation in *Container* was not "inevitable" because it resulted from two different methods of dividing the tax base: California employed formulary apportionment as a means of dividing the tax base, whereas other countries used separate accounting as a means of dividing the tax base. "Whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case." *Id.*

In *Japan Line* and the instant case, by contrast, there was no effort by the foreign taxing jurisdictions to divide the tax base. Rather they allocated 100 percent of the tax base to themselves. Consequently, when Los Angeles County or New Mexico sought to impose an apportioned tax on the same tax base, multiple taxation was "inevitable." Because foreign countries subjected 100 percent of the relevant base to tax, *any* apportioned tax imposed by another jurisdiction would result in multiple taxation. In short, we are not dealing here, as we were in *Container*, with two different methods of "divid[ing] the pie." *Id.* Rather, here (as in *Japan Line*) the entire pie has been subjected to tax by the foreign jurisdiction which leaves the states no room to tax even an apportioned slice.

There is a further point of distinction between *Container* and the instant case that accounts for the inevitability of the multiple taxation here. In *Container*, the combined income *and the combined factors* of Container and its unitary foreign subsidiaries were considered in determining the income that was properly attributable to California. Hence there was no certainty that, by including the foreign subsidiaries' income in the apportionable tax base, California would in fact *tax* such income. Rather, as a result of the inclusion of the foreign subsidiaries' factors in the apportionment formula, the income appor-

tioned to California could decrease, increase, or remain the same.[7]

Here, by contrast, while the income that NCR derived from its unitary foreign subsidiaries was included in its New Mexico apportionable tax base, the factors of those subsidiaries were ignored in apportioning the income to New Mexico. Consequently, there was dead certainty that New Mexico would *tax*—not merely apportion—every dollar of dividends, interest, and royalties that NCR received from its foreign subsidiaries,[8] and, accordingly, dead certainty that there would be international multiple taxation when such income was taxed on an unapportioned basis by foreign countries.

There is no merit to the suggestion advanced by the Department below that the "inevitability" of the multiple international taxation occasioned by New Mexico's tax may be questioned because some foreign countries did not exercise their right to tax NCR's dividends, interest, and royalties. There is worldwide recognition of the principle that the nation where income originates (the source nation) has the primary right to tax income having its source within that nation.[9] The dividends, interest, and royalties paid to NCR by its foreign subsidiaries

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[7] When a state considers both the income and the factors of foreign subsidiaries in the apportionment, two things happen: first, the apportionable tax base *increases*, because of the inclusion of the foreign subsidiaries' income; second, the apportionment percentage *decreases*, because the foreign subsidiaries' property, payroll, and sales add to the denominators, but not the numerators, of the corporation's apportionment factors for the taxing state. Thus, depending on the relative impact of these two changes, the income apportioned to the state will decrease, increase, or remain the same.

[8] When income is added to the apportionable tax base without modifying the factors employed to apportion such income, the necessary result is to tax such income. *See* note 7 *supra*.

[9] American Law Inst., *Federal Income Tax Project, International Aspects of United States Income Taxation* 6-7 (1987).

have their source in foreign nations.[10] Consequently, in accordance with the "custom of nations" (*Japan Line*, 441 U.S. at 447, 454), most of the foreign source dividends, interest, and royalties paid to NCR by its unitary foreign subsidiaries have been taxed to NCR abroad. Stip. ¶ 30 (App. B at 31a-33a).[11] The fact that some countries may have chosen to forbear from exercising their primary right to tax such income does not transform the inexorable clash between New Mexico's taxing scheme and the scheme embraced by the international community into the adventitious overlap that the Court found constitutionally tolerable in *Container*. Nor, of course, can it justify the "inevitable" multiple taxation that results when foreign nations do indeed exercise this primary right. In any event, if the notion of the "inevitability" of international multiple taxation is to be tied to its universality, it is incumbent upon this Court to delineate such a dramatic retrenchment in its Foreign Commerce Clause doctrine.

Finally, insofar as there are differences between this case, *Japan Line*, and *Container*, they underscore the need for the Court's consideration of this controversy. *Japan Line* articulated the principles limiting state taxation of foreign commerce, but, in contrast to this case, in the context of a property tax rather than an income tax. *Container* applied those principles to an income tax, but, in contrast to this case, in the context of a worldwide combined tax base where the subsidiaries' factors were fully represented. This case provides the Court with an opportunity to apply *Japan Line*'s principles to a tax on income which has been taxed by foreign countries

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[10] *See, e.g.*, I.R.C. §§ 861(a), 862(a) (source of dividends and interest generally based on residence of payor; source of royalties generally based on where royalty-producing property is used).

[11] Consistent with this custom of nations, the United States generally imposes a tax on dividends, interest, and royalties paid by United States residents to nonresidents. I.R.C. §§ 871-872, 1441-1442.

but with respect to which "factor representation" has been denied. The Court's review is necessary to delineate these principles in a manner that displays greater sensitivity to Foreign Commerce Clause concerns than did the court below and to provide guidance for tribunals like the Department below, which found that *"Container* did not clearly explain the concept of 'inevitability.'" App. B at 49a.

II. THE STATE COURT'S RULING THAT INCOME FROM UNITARY SUBSIDIARIES MAY BE INCLUDED IN THE APPORTIONABLE TAX BASE WITHOUT INCLUDING THE SUBSIDIARIES' FACTORS IN THE APPORTIONMENT FORMULA DISPOSES OF THE ISSUE THAT THIS COURT LEFT OPEN IN *MOBIL* AND CREATES A CONFLICT AMONG STATE COURTS OF LAST RESORT

In *Mobil,* this Court held that a state could include within the apportionable tax base of a nondomiciliary corporation the dividends that it received from its subsidiaries so long as the taxpayer and its subsidiaries were engaged in a unitary business. Although the taxpayer in *Mobil* had resisted that conclusion, it claimed that if its dividend income was constitutionally apportionable on the theory that it was engaged in a unitary business with its subsidiaries, then its income should have been apportioned under a method that included the subsidiaries' factors in the apportionment formula.

The Court declined to reach this question because it was not timely raised. *Mobil,* 445 U.S. at 441 n.15; *see also id.* at 449. Justice Stevens, however, did address the question in his dissent, where he declared:

> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause [the payee's in-state] income to be overstated.

Id. at 461 (Stevens, J., dissenting). The Court has subsequently expressed similar sentiments by observing that the fair apportionment requirement demands that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Container*, 463 U.S. at 169. *See also id.* at 168 n.5 (recognizing Justice Stevens' views in *Mobil*).

In holding that New Mexico could include NCR's dividends, interest, and royalties received from its unitary foreign subsidiaries in NCR's apportionable tax base while denying NCR the right to include the subsidiaries' factors in its apportionment formula, the court below has disposed of the issue this Court left open in *Mobil* and, in so doing, has created an irreconcilable conflict with decisions of other state courts. The Supreme Court of Maine and the Wisconsin Court of Appeals have each recognized a taxpayer's right to "factor representation" when income received from subsidiaries is included in the taxpayer's apportionable tax base. *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991); *American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue*, 143 Wis. 2d 533, 422 N.W.2d 629 (Ct. App. 1988). The Supreme Court of Rhode Island has recognized a similar principle with respect to partnership income received by a corporation. *Homart Dev. Co. v. Norberg*, 529 A.2d 115 (R.I. 1987). Other courts, however, have agreed with the New Mexico Court of Appeals that "factor representation" is not constitutionally required, at least in the absence of a demonstration by the taxpayer that failure to provide for "factor representation" produces a "grossly distorted result." *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (1988); *NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn.), *cert. denied*, 493 U.S. 848 (1989);[12] *cf. NCR Corp. v. South*

[12] When this Court denied certiorari in the Minnesota *NCR* case, the *Tambrands* case had not yet been decided and the petitioner had not brought the *Homart* case to the Court's attention. *See* Petition for Certiorari, *NCR v. Commissioner of Revenue.*

Carolina Tax Comm'n, 304 S.C. 1, 21-23, 402 S.E.2d 666, 673-74 (1991) (recognizing failure to provide "factor representation" was "not ideally fair," but conditioning relief on proof of a "gross disparity" of "constitutional proportions").

In *Tambrands*, the question was whether Maine could constitutionally include dividend income that the taxpayer received from its unitary foreign subsidiaries in the taxpayer's apportionable tax base without including the subsidiaries' factors in the taxpayer's apportionment formula. Relying on this Court's decision in *Container* (*see* 595 A.2d at 1044-45) and on Justice Stevens' dissent in *Mobil* (*see id.* at 1044 n.9), the Maine Supreme Court concluded that the "ineluctable result" of including the income derived from the taxpayer's unitary foreign subsidiaries in the apportionable tax base while excluding their factors from the formula "is that more of the business activity of the unitary business is attributed to Maine than is the actual case." *Id.* at 1044. The court concluded:

> Maine cannot, under the fairness principles of the due process clause requiring that the income it taxes be rationally related to values connected to the taxing state, include in Tambrands' "apportionable tax base income from its . . . affiliates operating abroad . . . [and] apportion such income by factors reflecting only [Tambrands' domestic] operations." W. Hellerstein, *Dividing the State Corporate Income Tax Base: Developments in the Supreme Court and Congress*, appearing in *The State Corporation Income Tax* 293 (C. McLure, Jr. ed. 1984).

Id. (brackets in original).

In *American Tel. & Tel.*, the question was whether Wisconsin could constitutionally include dividend and interest income that the taxpayer received from its unitary subsidiaries in the taxpayer's apportionable tax base without including either the subsidiaries' property or,

alternatively, the value of the taxpayer's investment in its subsidiaries, in the property factor of the taxpayer's apportionment formula. The Wisconsin Court of Appeals acknowledged that this Court had failed to address the merits of this issue in *Mobil* (*see* 143 Wis. 2d at 548, 422 N.W.2d at 635), but noted that commentators had recognized the force of the constitutional attack leveled at

> apportionment formulas which allegedly give insufficient weight to the sales, property and payroll of subsidiaries which make dividend, interest, royalty, and other payments to the parent corporation which are included by the taxing state as income subject to apportionment.

143 Wis. 2d at 549, 422 N.W.2d at 635. The court concluded that the inclusion in AT&T's apportionable tax base of dividends and interest it received from its unitary subsidiaries, without adjustment of the apportionment formula's property factor to reflect the subsidiaries' contribution to the production of that income, was constitutionally impermissible. "[T]he apportionment formula used by the department does not reflect a reasonable sense of how AT&T's income is generated and taxes value earned outside the borders of Wisconsin, contrary to . . . the due process and commerce clauses of the United States Constitution." 143 Wis. 2d at 551, 422 N.W.2d at 636.

In *Homart*, the question was whether Rhode Island could include a nondomiciliary corporation's partnership income in the corporation's apportionable tax base without reflecting the partnerships' factors in the corporation's apportionment formula. In holding that "factor representation" was required, the Rhode Island Supreme Court declared:

> The inclusion of this income in Homart's net-income calculation for apportionment purposes necessarily requires that the payroll, property, and receipt factors that gave rise to it be included in the appor-

> tionment equation also. Otherwise, the net income is subject to an apportionment ratio that reflects only Homart's in-state and everywhere business activity when, in fact, this income did not arise from Homart's corporate business activity but instead arose out of the partnerships' business activities that were not reflected in the apportionment ratio.

Homart, 529 A.2d at 121.

Indeed, even those courts that have concluded, along with the court below, that "factor representation" is unnecessary in the absence of proof of "gross distortion," have recognized the unfairness of including income from unitary subsidiaries in the apportionable tax base without adjusting the apportionment formula to reflect the subsidiaries' income-producing activities. *See NCR Corp. v. Comptroller of the Treasury*, 313 Md. at 151, 544 A.2d at 780-81; *NCR Corp. v. South Carolina Tax Comm'n*, 304 S.C. at 21-22, 402 S.E.2d at 673-74. These courts' reliance on the good-enough-for-government-work defense that a theoretically defective apportionment can be justified so long as the resulting distortion is not too great raises a question that itself is worthy of this Court's review. *See, e.g., Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920) (apportionment formula may be struck down as "inherently arbitrary"); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 133 (1931) (apportionment formula may be struck down as "intrinsically arbitrary"). When this question is considered in conjunction with the conflict that the decision below has created with decisions of other state courts, the need for this Court's guidance is clear.

III. THE ISSUES OF BOTH INTERNATIONAL MULTIPLE TAXATION AND "FACTOR REPRESENTATION" RAISED BY THE DECISION BELOW ARE RECURRING QUESTIONS OF GREAT PRACTICAL IMPORTANCE

Wholly apart from the incompatibility of the state court's decision with this Court's Foreign Commerce

Clause precedents and apart from the conflict that the decision has created with other state courts of last resort, the decision below warrants this Court's review because it presents recurring questions of great practical importance.

The issue raised by this case arises in virtually every state with a corporate income tax. Like New Mexico, the overwhelming majority of states include dividends, interest, and royalties that a corporate taxpayer receives from unitary foreign subsidiaries in the taxpayer's apportionable tax base.[13] Like New Mexico, the overwhelming majority of states fail to provide for "factor representation" when such income is included in a taxpayer's apportionable tax base. Indeed, petitioner is aware of only two instances in which a state by statute provides for "factor representation" with respect to such income. N.H. Rev. Stat. Ann. § 77-A:3, II(b) (1991) ("factor representation" for dividends from unitary foreign affiliates); Utah Code Ann. § 59-7-303(4) (1992) (same). Consequently, the questions raised by the decision below—both with respect to international multiple taxation and with respect to "factor representation"—are constantly arising in almost every corporate income tax state for thousands of taxpayers. These questions have resulted in widespread disputes between taxpayers and state taxing

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[13] The vast majority of states use federal taxable income as the starting point for calculating state taxable income. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 125 (1993). The federal tax base generally includes dividends, interest, and royalties received from foreign affiliates. I.R.C. §§ 61, 1504. Accordingly, unless explicitly excluded, such foreign source income is includable in the apportionable tax base in most states. Although some states provide a complete deduction for dividends from foreign affiliates, most provide only a partial deduction or none at all. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 79 (1993) (and paragraphs cited therein). Moreover, only a handful of states exclude foreign source interest or royalties from the apportionable tax base. *See, e.g.*, Ohio Rev. Code Ann. § 5733.04(I)(2) (Anderson 1991); Va. Code Ann. §§ 58.1-302, 58.1-402(c)(8) (Michie 1991 & Supp. 1993).

authorities, as illustrated by the cases already cited in this petition and many others that are currently pending in state courts and administrative tribunals.

The amount of taxes at stake in these controversies is enormous. Thousands of taxpayers annually receive billions of dollars in foreign source dividends, interest, and royalties,[14] and much of this income is includable in their state apportionable tax bases.[15] Indeed, NCR's foreign source dividends, interest, and royalties constituted on average more than 62 percent of its New Mexico tax base (*see supra* p. 5), and in 1986 NCR's foreign source income constituted its entire apportionable tax base. *See* Stip. ¶¶ 29, 33. *See also Mobil*, 445 U.S. at 430 (involving "substantial amounts received as dividends from its subsidiaries and affiliates operating abroad"); *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Finance*, 112 S. Ct. 2365 (1992) (involving over $10 million of dividends received from unitary foreign subsidiaries).

In view of the large number of taxpayers that are subject to taxing schemes like New Mexico's and the significant amounts of tax dollars involved, the practical importance of this controversy is self-evident.

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[14] In 1986 alone, approximately $5.6 billion of dividends and $3.8 billion of interest, rents, and royalties were paid to large U.S. corporations (*i.e.*, those with total assets of at least $500 million) by their 7500 largest controlled foreign corporations. Internal Revenue Service, Statistics of Income Division, *Compendium of Studies of International Income and Taxes*, Pub. 1267 (9-91), 223. In 1988, 744 of these largest U.S. corporations filed information returns reflecting their holdings in controlled foreign corporations. Internal Revenue Service, *Statistics of Income Bulletin*, Vol. 12, No. 2 (Fall 1992), 71. When one takes account of smaller corporations, the total number of corporations with foreign subsidiaries is obviously much larger.

[15] Although the foreign source income figures cited in note 14 *supra* include amounts paid by both unitary and nonunitary affiliates, plainly the amounts attributable to unitary subsidiaries are substantial.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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APPENDIX A

COURT OF APPEALS OF NEW MEXICO

No. 13,035

NCR CORPORATION,
Protestant-Appellant,

v.

TAXATION AND REVENUE DEPARTMENT OF THE STATE OF NEW MEXICO,
Respondent-Appellee.

May 6, 1993

DONNELLY, Judge

OPINION

NCR Corporation (NCR) appeals from an administrative decision and order of the State Taxation and Revenue Department (Department), denying NCR's challenge to four separate deficiency assessments of corporate income tax, penalty, and interest. It contends that (1) the Foreign Commerce Clause, Article I, Section 8, Clause 3 of the United States constitution prohibits New Mexico from imposing a corporate income tax upon NCR's foreign source royalty, interest, and dividend income; (2) the Due Process Clause, Amendment XIV of the United States Constitution prohibits New Mexico from taxing an apportioned share of NCR's Subpart F income; and (3) the Due Process Clauses of the state [1] and federal constitu-

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[1] N.M. Const. art. II, § 18 (Repl. Pamp. 1992).

tions require that New Mexico modify its apportionment formula as it relates to NCR. We affirm the decision and order of the administrative hearing officer entered below; we remand, however, for determination of the amount of credits due for taxes previously paid by NCR.

FACTS

The Department issued corporate income tax assessments against NCR for taxes due in 1981 through 1987, totalling approximately $439,681.80, plus interest and penalties. The assessments principally relate to income earned outside the United States by NCR and its foreign subsidiaries. NCR protested each of the assessments and its challenges were consolidated for hearing before a hearing officer on August 29, 1990.

The parties stipulated, inter alia, that NCR was incorporated in Maryland and maintains its corporate headquarters and principal place of business in Ohio. NCR is engaged in the manufacture of business equipment, computers, and machinery, and sells its products, supplies, and services at wholesale and retail world-wide. It conducts its businesses in foreign countries either directly or through its foreign subsidiaries and branches, through the ownership of stock in foreign subsidiaries, through ownership of patents and license agreements with foreign subsidiaries, and through loan agreements. NCR does not contest New Mexico's taxation of its branch income. The operation of NCR's foreign subsidiaries and its foreign branches is nearly identical. All significant operating decisions for both branches and subsidiaries are made at NCR's corporate headquarters in the United States. The royalties, interest, and dividends received by NCR from its foreign subsidiaries were treated as gross income of NCR. Either NCR or its foreign subsidiaries was subject to tax on the income earned in the host country.

During the years in question, NCR had seventeen manufacturing facilities throughout the world; each was operated either directly by NCR or through a subsidiary. During this same time period, NCR conducted business in all fifty states, including New Mexico. NCR had ten domestic subsidiaries, approximately seventy-five foreign subsidiaries, and eighteen foreign branches. Approximately 70% of all products sold by NCR are manufactured in the United States and shipped overseas. NCR does business essentially through its domestic and foreign subsidiaries operating together as a fully-integrated unitary business and, except for its Japanese subsidiary, NCR owns 100% of the stock of its other foreign subsidiaries.

The income tax assessed by the Department against NCR during the applicable time periods was based upon an apportionment formula utilized by the state and which apportioned a share of NCR's total income as reported to the federal government. To calculate the amount of tax due, the Department took NCR's reported federal taxable income, deducted foreign dividend gross-up, income from United States obligations, and non-business income allocated to other states, and then apportioned NCR's New Mexico income in accordance with the statutory formula specified by the Uniform Division of Income for Tax Purposes Act (UDITPA). NMSA 1978, §§ 7-4-1 to -21 (Repl. Pamp. 1990). The Department then imposed an apportioned income tax by taxing NCR's unitary business income.[2]

The tax imposed by the Department, subject to certain deductions, is levied on a percentage basis determined by comparing NCR's New Mexico business income to the remainder of its business. This formula resulted in a tax apportionment factor, which varied depending on

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[2] New Mexico utilizes a hybrid system of corporate income tax reporting. *See Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 168 (1983).

the applicable year, of between 0.3307% and 0.2207% of NCR's annual federal taxable income.

Following the administrative hearing, the hearing officer disallowed NCR's protest of each of the tax assessments imposed by the Department, except insofar as NCR protested the inclusion of a portion of its Subpart F income which was previously taxed in New Mexico, and except for allowance of a deduction for previous tax payments made by NCR for the tax years in question.

I. *Foreign Commerce Clause*

NCR contends that the Foreign Commerce Clause of the United States Constitution bars imposition of New Mexico's corporate income tax upon a proportionate share of NCR's corporate income received in the form of royalties, interest, and dividends from its foreign subsidiaries, and which is earned in, and subject to taxation by, foreign countries. In advancing this argument, NCR argues that allocation of NCR's corporate income to a single situs and apportionment is constitutionally prohibited under the Foreign Commerce Clause, and that New Mexico's apportionment formula results in impermissible multiple international taxation and contravenes national policy.

NCR asserts that New Mexico's statutory apportionment formula is prohibited under the Foreign Commerce Clause because Section 7-4-10 must be read to require inclusion of its entire property, payroll, and sales of its dividend, royalty, and interest-paying foreign subsidaries in calculating the denominator of the apportionment factor applied to the taxable portion of its foreign income. Thus, it contends the tax in question is a tax on its foreign subsidiaries. We do not believe the statute or its application in the instant case offends the Foreign Commerce Clause. Reading Sections 7-4-10, -11, -14, and -16 together, and in light of the provisions of UDITPA, we think, evinces a clear legislative intent to impose the

tax on the property, payroll, and sales of the unitary business of the "taxpayer." In this case the "taxpayer" is NCR, not its foreign subsidiaries. *See Giant Indus. Ariz., Inc. v. Taxation & Revenue Dep't,* 110 N.M. 442, 445, 796 P.2d 1138, 1141 (Ct. App. 1990) (fundamental purpose of statutory interpretation is to further legislative intent and purpose).

New Mexico utilizes a three-factor apportionment formula as set forth in UDITPA. A majority of states, including New Mexico, have adopted UDITPA, or a variation of such uniform legislation. *Barclays Bank Int'l. Ltd. v. Franchise Tax Bd.,* 829 P.2d 279, 282 (Cal. 1992) (en banc); *see also* 1 *State Tax Guide* ¶ 10-110, at 1061-63 (Commerce Clearing House, 2d ed.1991); 4 Zolman Cavitch, *Business Organizations* § 7904, at 7929 (1992); *see generally* Larry D. Scheafer, Annotation, *Construction and Application of Uniform Division of Income for Tax Purposes Act,* 8 A.L.R.4th 934 (1981); Uniform Division of Income for Tax Purposes Act, 7A U.L.A. 331 (1985).

As specified in UDITPA, Section 7-4-10, "All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three." Under this statutory formula, the income attributable to the state is determined by multiplying the taxpayer's gross income by a fraction which represents the ratio of sales, payroll, and property located in the state to the total sales, payroll, and property of the corporation.

Relying in part upon the decision in *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979), NCR also asserts that the Foreign Commerce Clause precludes the state, even on an apportioned basis, from imposing any tax upon the royalty, interest, and dividend income earned by it from its foreign subsidiaries, because this income has already been taxed on an unapportioned basis

by the government of the foreign country in which the income was generated and earned. NCR argues that in Japan Line, which involved a challenge of local taxation of foreign, rather than interstate commerce, the Court held that the Foreign Commerce Clause imposed greater restraints upon state taxing authority than those articulated in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), relating to restrictions emanating from the Interstate Commerce Clause. It argues that the hearing officer erred in failing to determine, under the rationale of *Japan Line,* that the taxes assessed fail to satisfy constitutional scrutiny. We reach a different conclusion from that asserted by NCR and find that the tax imposed here survives the six-part test set forth in *Japan Line.*

In *Complete Auto Transit,* the United States Supreme Court observed that where purely *interstate* commerce is involved, a state tax will survive Commerce Clause scrutiny when "the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id.,* 430 U.S. at 279.

In *Japan Line* the Court applied a six-part test, holding that where a taxing authority seeks to tax foreign commerce it must satisfy the four-part inquiry set forth in Complete Auto Transit to determine the validity of state or local taxation of interstate commerce and, in addition, must satisfy two additional considerations:

> [F]irst, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments." If a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause.

Japan Line, 441 U.S. at 451.

Pointing to the decisions in *Japan Line* and *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), NCR contends that New Mexico, in seeking to tax the income of a multistate or multinational business, is limited under the Commerce Clause and Foreign Commerce Clause to taxing only the income of such an entity earned within the state. We do not read the authorities relied upon by NCR so restrictively. While it is true that in *ASARCO, Inc.* and *Container Corp.*, the Supreme Court held that under both the Due Process Clause and the Commerce Clause a state may not impose an income tax upon value earned by a taxpayer beyond the state's borders, the Court, in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439-40 (1980), recognized that a state may lawfully impose a fairly apportioned income tax upon such taxpayer. The general premise underlying unitary taxation is that the value of a corporation's unitary business is apportionable to a state for taxation if the corporation's operations within the state contribute to the profitability of the entity's overall business. *Id.*

Similarly, the Court in *Container Corp.* observed that multiple taxation of a multinational, world-wide unitary enterprise may, when properly apportioned, survive the restrictions articulated in *Japan Line*. Although the *Japan Line* Court held that a state tax on foreign instrumentalities of commerce may neither impose multiple tax burdens on international commerce nor impair federal uniformity in an area where federal uniformity is essential, in a subsequent decision, *Container Corp.*, the Court declined to declare invalid California's apportioned corporate income tax. *Container Corp.* held that while "[a]llocating income among various taxing jurisdictions bears some resemblance . . . to slicing a shadow," *id.*, 463 U.S. at 192, nevertheless, it was unwilling to require a state to give up one method of allocation that may at times result in double taxation in favor of another allocation method that may also result in double taxation. *Id.* at 193-96. Thus, the *Container Corp.* Court declined to infer that the state's use of unitary taxation

violated a clear federal policy requiring uniform state income taxation of foreign commerce. The United States Constitution does not impose any single method of apportionment on a multistate or multinational taxpayer's income. *See Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 445 (1940).

The Department disputes NCR's claims that the Supreme Court's decision in *Japan Line* is dispositive of the issue of constitutionality raised here. The Department asserts that the court's decision in *Japan Line* is inapplicable to the facts of the instant case because *Japan Line* involved a challenge to the taxing authority's imposition of an ad valorem property tax on cargo containers owned by Japanese companies engaged in foreign commerce and which were transported to California ports en route to other places. We agree. Unlike the situation in *Japan Line*, which involved six Japanese shipping companies engaged in the transport of cargo in foreign commerce. and an ad valorem property tax, which was determined to constitute an unlawful restraint on foreign commerce, the present case presents a different factual basis. Here, NCR is domiciled in the United States, engages in business in New Mexico, and the tax in question is an apportioned corporate income tax on NCR's unitary business income.

In contrast to the tax involved here, the tax imposed in *Japan Line* was a tax on a foreign entity, not a domestic corporation. In *Japan Line* several municipalities in California levied ad valorem personal property taxes on cargo containers used by the shipping companies. The cargo containers were taxed at full value in Japan. Moreover. unlike the situation in *Japan Line*, the Court in *Container Corp.* unheld the tax in question, noting that the California net income tax was imposed on the domestic parent of foreign subsidiaries and not upon a foreign entity. *Container Corp.*, 463 U.S. at 195.

Does the New Mexico corporate income tax apportionment scheme, as applied in this case, pass constitu-

tional muster against contentions that such tax fails to survive Commerce Clause scrutiny and violates the Foreign Commerce Clause? We conclude that it does and that the basic premise and holding of the Court in *Container Corp.* is controlling here.

The income the Department seeks to tax is derived from NCR's subsidiaries that operate together as a fully-integrated unitary business. *Cf. Kewanee Indus., Inc. v. Reese*, — N.M. —, — n.5. 845 P.2d 1238, 1242 n.5 (1993). The tax in question is not a tax on any of NCR's foreign subsidiaries; instead, the tax falls upon an apportioned share of NCR's income which it receives in the form of royalties, interest, and dividends from its unitary foreign subsidiaries. The fact that the tax is apportioned in part upon NCR's foreign income sources does not constitute a bar to state taxation. *See Mobil Oil Corp.*, 445 U.S. at 439-40.

NCR's argument that both the Commerce Clause and the Foreign Commerce Clause of the United States Constitution prohibit New Mexico from imposing its income tax on NCR's royalties, interest, and dividends which were subject to the taxing jurisdiction of foreign countries, has been considered and rejected in several other jurisdictions. *See NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn.), *cert. denied*, 493 U.S. 848 (1989); *NCR Corp. v. South Carolina Tax Comm'n*, 402 S.E.2d 666 (S.C.1991); *see also NCR Corp. v. Comptroller of the Treasury, Income Tax Div.*, 544 A.2d 764 (Md.1988). We find these decisions instructive in the instant case.

The Minnesota Supreme Court, in *Commissioner of Revenue*, considered a similar argument by NCR and concluded that the Minnesota unitary business income tax apportionment formula did not violate the Due Process or Foreign Commerce Clauses of the United States Constitution, or result in impermissible multiple taxation.

In *South Carolina Tax Commission* the South Carolina Supreme Court turned aside a similar argument to that raised by NCR in the instant case. In that case, as here, NCR placed great reliance on the Supreme Court's decision in Japan Line. The South Carolina court found unpersuasive NCR's claim that the Foreign Commerce Clause precluded the tax commission's inclusion in NCR's total taxable income the royalty and interest income it received from its foreign subsidiaries. In rejecting this argument, the court held:

> [T]he case controlling the situation here is not *Japan Line* in our view, but *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 . . . (1983). In *Container Corp.* the Court retreated from its broad *Japan Line* rules and in our view restricted *Japan Line* substantially. *Container Corp.* again involved a California tax. This time, however, the tax was an apportioned corporate income tax on Container Corporation, a company headquartered in Illinois but doing business in California as well as other states and countries. California imposed the same three-factor apportionment formula upon Container [C]orporation as was here imposed by the Tax Commission on NCR.

South Carolina Tax Comm'n, 402 S.E.2d at 670.

We arrive at a similar result to that reached by the court in *South Carolina Tax Commission* and the Minnesota Supreme Court in *Commissioner of Revenue*, each of which denied related challenges of NCR to the imposition of an apportioned state income tax.

In rejecting the arguments advanced above, we have also considered NCR's contention that New Mexico's tax impairs federal uniformity in an area where uniformity is essential and that the imposition of such tax may impede federal policy. We do not agree that the limitations cited by NCR bar the imposition of the tax here in issue. In *Japan Line* the Court held that to withstand scrutiny under the Foreign Commerce Clause a state tax must meet the standards with respect to state taxation

of interstate commerce enunciated in *Complete Auto Transit* and, additionally, the tax must not give rise to the risk of multiple taxation or prevent the federal government from speaking with one voice when regulating commercial relations with foreign countries. *Japan Line*, 441 U.S. at 453; see also *Colgate-Palmolive Co. v. Franchise Tax Bd.*, 13 Cal.Rptr.2d 761, 767 (Ct.App.1992) (unitary state tax held to survive constitutional challenge alleging violation of Foreign Commerce Clause, where tax meets requirements of Interstate Commerce Clause test and tax is not shown to create substantive risk of international taxation and does not impair need for federal uniformity where federal uniformity is essential).

Applying this test to the facts before us, we conclude that NCR's challenges here must fail.[3] Contrary to the contentions of NCR, in the instant case, New Mexico is taxing only an apportioned share of the income of NCR, a domestic corporation, not imposing a tax on tangible property of a foreign corporation. Unlike the situation in *Japan Line*, multiple taxation, although real, is not inevitable, the tax was fairly apportioned under the formula set forth in UDITPA, and the legal incidence of the tax here does not fall on a foreign owner but instead is upon a unitary, domestic entity. Moreover, NCR has failed to establish that the tax here violates the "one voice" standard or implicates foreign policy issues which must be left to the United States government. *Cf. Intel Containers Int'l Corp. v. Huddleston*, — U.S. —, —, 113 S. Ct. 1095, 1103, 122 L. Ed. 2d 421, 435 (1993) (Tennessee's sales tax as applied to cargo containers leased by corporation for use in international shipping found not to violate the Foreign Commerce Clause under *Japan Line*'s

[3] In *Container Corp.* the Court observed, "[I]f a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States.'" *Id.*, 463 U.S. at 194 (quoting *Mobil Oil Corp.*, 445 U.S. at 448).

three-part test, and tax did not create substantial risk of multiple taxation implicating foreign commerce concerns).

II. *Commerce Clause—NCR's Subpart F Income*

NCR argues, alternatively, that even if this Court affirms the hearing officer's determination that its foreign source royalties, interest, and dividends can be included in its New Mexico apportionable tax base without impinging upon the limitations of the Foreign Commerce Clause, nevertheless, under the Due Process Clause, the state is precluded from including in its apportionable tax base the Subpart F portion of NCR's foreign source dividends.

NCR argues that its Subpart F income is exempt from taxation by the Department because income may not be taxed until it is actually realized. Thus, it asserts that this principle precludes taxation of a shareholder on income earned by NCR until it is distributed.

The Commerce Clause states that "Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3. The Commerce Clause has been recognized as a restriction upon the power of a state to regulate or tax interstate and foreign commerce even in the absence of the enactment of specific congressional legislation. *See Container Corp.*, 463 U.S. at 164; *Japan Line*, 441 U.S. at 444; *see generally* E.H. Schopler, Annotation, *Validity, Under Federal Constitution, of State Tax On, Or Measured by, Income of Foreign Corporation*, 67 A.L.R.2d 1322 (1959); Scheafer, *supra*. The Foreign Commerce Clause of the United States Constitution also imposes restrictions upon the taxing authority of the states. *See Japan Line*, 430 U.S. at 451.

NCR contends that its Subpart F income is not business income under Section 7-4-2(A) and is not appor-

tionable under Section 7-4-10. NCR bases its challenge to the inclusion of its Subpart F income on three principal grounds. First, it contends that Subpart F income is hypothetical income, similar to gross-up income which this state does not tax; hence, it contends, Subpart F income is not subject to taxation. Second, NCR argues that the Department is barred from taxing Subpart F income under the Due Process Clause of the United States Constitution. Third, it argues that a portion of its Subpart F income has been previously taxed and New Mexico is precluded by the Equal Protection Clause, the Commerce Clause, and the Due Process Clause of the New Mexico Constitution from taxing this income a second time. We disagree.

In *Estate of Whitlock v. Commissioner of Internal Revenue Service*, 59 T.C. 490 (1972), *aff'd*, 494 F.2d 1297 (10th Cir.1974), the court rejected the argument that Subpart F income is hypothetical. Subpart F of the Internal Revenue Code (IRC), 26 U.S.C. §§ 951-964 (1982), contains a limited exception to the general rule that shareholders are not subject to taxation on the undistributed earnings of their corporations. IRC Section 951(a)(1) provides that United States shareholders of "controlled foreign corporation[s]" are required to report as income their pro rata share of such corporation's undistributed income, consisting of the controlled foreign corporation's "Subpart F income" and its increase in earnings invested in United States property. The effect of such legislation is to provide that the shareholders of controlled foreign corporations shall be treated as if they had received actual dividend distributions from such corporations even though no income has been actually distributed. IRC § 951(a)(2).

Under IRC Section 951(a)(2)(A), a shareholder of a controlled foreign corporation must include in its share of such corporation's Subpart F income that income "which would have been distributed with respect to the

stock which such shareholder owns . . . if . . . it had distributed [a pro rata share of] . . . its subpart F income," reduced by certain actual dividend distributions. Id. United States shareholders must also include in his or her pro rata share of the amount of earnings that a controlled foreign corporation invests in United States property for any taxable year "to the extent not excluded from gross income under [other provisions of the Internal Revenue Code]." IRC § 951(a)(1)(B).

NCR also argues that the Due Process Clause of the United States Constitution confines the state's power to tax nondomiciliary corporations engaged in interstate or foreign business to income or property that has its source within the state. *See, e.g., Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 272-73 (1978); *Norfolk & W. Ry. v. Missouri State Tax Comm'n,* 390 U.S. 317, 325 (1968). We do not find this argument persuasive under the facts existing here. As observed by the United States Supreme Court in *Mobil Oil Corp.,* 445 U.S. at 438:

> The argument that the source of the income precludes its taxability runs contrary to precedent. In the past, apportionability has often been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities formed part of a single unitary business.

In the instant case it is undisputed that there is a substantial flow of goods between NCR and its domestic and foreign subsidiaries and branches, and that NCR conducts its business world-wide through its domestic and foreign subsidiaries as a single, integrated unitary operation. Since NCR conducts part of its unitary business in this state, New Mexico has the right to impose a corporate income tax on an apportioned share of NCR's unitary income. *See F.W. Woolworth Co. v. Taxation & Revenue Dep't,* 458 U.S. 354 (1982) (state may tax

corporation income if it arises from subsidiaries whose business is part of the corporation's unitary business). We have examined each of the arguments and authorities relied upon by NCR, including its challenge on state constitutional grounds, and conclude that because its subsidiaries with Subpart F income remain part of its unitary business and the federal government requires inclusion of NCR's Subpart F income in the corporation's gross income, under the unitary business principle, the state assessments in question here do not violate the United States or New Mexico Constitutions, are fairly apportioned, and tax a fair portion of such income. *See Mobil Oil Corp.*, 445 U.S. at 438; *see also Container Corp.*, 463 U.S. at 165-67; *Comptroller*, 544 A.2d at 768-70; *see generally* William D. Dexter, *Attribution of a Multinational Corporation's Net Income: The Position of Unitary States Regarding Combined Reporting*, 18 Vand. J. Transnat'l L. (1985).

III. *Validity of Apportionment*

NCR's final argument raised on appeal asserts that even if this Court upholds the decision of the hearing officer against its first and second challenges, nevertheless, New Mexico's apportionment method must be modified so as to reflect certain factors which give rise to NCR's foreign source income. In advancing this contention, NCR asserts that New Mexico's apportionment statute, Section 7-4-10, necessitates inclusion of all or a portion of its foreign subsidiaries, expenses in computing NCR's proper formula percentage. NCR also contends that its disputed foreign source income (royalties, interest, and dividends) is neither taxable nor apportionable by New Mexico because (1) that income is earned by NCR in foreign countries where such income is subject to an unapportioned tax and that income is not attributable to New Mexico; and (2) NCR's Subpart F income may not be taxed by New Mexico and may not be subjected to apportionment by the state.

NCR urges this Court to follow the reasoning of Justice Stevens in his dissenting opinion in *Mobil Oil Corp.* which argues that "[u]nless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause [the corporation's] income to be overstated." *Id.*, 445 U.S. at 449, 461 (footnote omitted). In resolving this issue, however, we are guided by the rationale of the majority decision which rejected the views set forth in the dissent.

In challenging the efficacy of New Mexico's apportionment formula, as applied here, NCR further argues that the formula fails to satisfy the test of fairness set forth in *Container Corp.* In *Container Corp.* the Supreme Court emphasized that two standards must be met in order for an apportionment formula to be fair, e.g., "internal consistency," and "external consistency." *Id.*, 463 U.S. at 169. The test of internal consistency is that the formula must be such that if it were applied by every jurisdiction, it would result in a tax which does not exceed the unitary business's income. The requirement that the apportionment formula satisfy external consistency mandates that the factors used in the apportionment scheme "actually reflect a reasonable sense of how income is generated." *Id.*

As noted in *Container Corp.*, a taxpayer seeking to invalidate a state's apportionment formula must show by clear and cogent evidence that the income attributed to the state is in fact disproportionate to the business transacted in that state. *Id.*, 463 U.S. at 179, 180-81. In *South Carolina Tax Commission* the South Carolina Supreme Court, guided, in part, by the Supreme Court's decision in *Container Corp.*, rejected a like contention by NCR that South Carolina's statutory apportionment scheme impermissibly required NCR's foreign subsidiaries, payroll, property, and sales to be included in the denomi-

nator of that state's apportionment formula. Similarly, in *Comptroller*, 544 A.2d at 768, the Maryland Court of Appeals noted:

> "Under both the Due Process and Commerce Clauses of the [United States] Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 164 . . . (quoting *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 . . . (1982)). Nonetheless, "[i]t has long been established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation." *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 423, 436 . . . (1980). . . .
>
> In order to challenge successfully State apportionment of corporate income, "the taxpayer [must] . . . prove 'by clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State . . . . or has led to a grossly distorted result. . . .'" *Container Corp., supra*, 463 U.S. at 170 . . . (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 . . . (1978)).

Has NCR established that New Mexico's apportioned income tax upon a share of its unitary income for the years in question results in a grossly distorted result? We hold that it has not. *See id.*; *see also Tipperary Corp. v. New Mexico Bureau of Revenue*, 93 N.M. 22, 24, 595 P.2d 1212, 1214 (Ct.App.) (taxpayer has duty to present evidence overcoming correctness of assessment), *cert. denied*, 92 N.M. 675, 593 P.2d 1078 (1979); *cf. Crocker Equip. Leasing, Inc. v. Department of Revenue*, 838 P.2d 552, 557 (Or.1992) (en banc) (taxpayer has burden of proving that statutory apportionment formula does not fairly represent taxpayer's business activity). NCR has failed to establish that the method of apportionment

utilized by the Department is contrary to law or unfairly applied for the time periods in question. Similarly, we conclude that New Mexico's apportionment statute, Section 7-4-10, and the assessments challenged herein meet the test of fairness specified in *Container Corp.*, and do not violate the Due Process and Commerce Clauses of the United States Constitution or the Due Process Clause of the New Mexico Constitution. N.M. Const. art. II, § 18 (Repl. Pamp.1992). Based upon the record before us, however, we note that the hearing officer found that NCR is entitled to credits for income taxes previously paid by it for certain of the years in question. Since a portion of NCR's Subpart F income was previously taxed for the tax years 1978 through 1980, we agree that NCR is entitled to an adjustment of the tax assessment. Neither NCR nor the Department has contested this portion of the hearing officer's ruling.

CONCLUSION

We affirm the decision and order entered below. We remand, however, for determination by the hearing officer of the amount of the allowable adjustment from the additional taxes imposed, because of NCR's previous payment of taxes for certain of the years in question.

IT IS SO ORDERED.

/s/ Thomas A. Donnelly
THOMAS A. DONNELLY
Judge

WE CONCUR:

/s/ A. Joseph Alarid
A. JOSEPH ALARID
Judge

/s/ Benjamin Anthony Chavez
BENJAMIN ANTHONY CHAVEZ
Judge

APPENDIX B

BEFORE THE HEARING OFFICER OF
THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO

IN THE MATTER OF NCR CORPORATION,
I.D. No. 01-009509-00 6, Protest to
Assessment No. 5909, 5929, 5932 and 7846

DECISION AND ORDER

This matter came on for hearing on August 29, 1991 before Gerald B. Richardson, Hearing Officer. NCR Corporation was represented by its local counsel, Curtis W. Schwartz, Esq., and by Paul H. Frankel, Esq. of Morrison and Foerster of New York, at the hearing. Leave was granted for Walter Hellerstein, Esq., also of Morrison and Foerster, to join Messrs. Schwartz and Frankel on behalf of NCR Corporation in the briefing process. The Taxation and Revenue Department, hereinafter the Department, was represented by Daniel Yohalem, Esq. At the hearing, the parties presented an extensive stipulation of facts, which left a few numerical details to be worked out after the parties reviewed additional information which had recently been exchanged. A finalized version of the stipulated facts was submitted to the hearing officer on November 2, 1990, during the briefing process. The parties are to be commended for their hard work and cooperation in arriving at the extensive stipulation of facts which was submitted. The result is that all relevant facts have been stipulated to by the parties, leaving the hearing officer only the difficult task of resolving the legal issues presented by this matter. The stipulated facts are

hereby adopted in their totality as this hearing officer's findings of fact and are set forth fully below.

At the close of the hearing, the parties agreed that they would submit their arguments in the form of written briefs. The briefing process was completed with the submission on January 15, 1991 of NCR Corporation's reply brief. Due to the complexity of this matter, the parties agreed to a somewhat extended briefing process to allow for full exposition of the issues. The parties also agreed to grant the hearing officer an additional 30 days beyond the 30-day time limit found at Section 7-1-24(H) NMSA 1978 to render his decision in this matter. Both parties are to be complimented on the excellent briefs which were submitted. Based upon the evidence and the arguments submitted in this matter, IT IS DECIDED AND ORDERED that:

FINDINGS OF FACT

1. NCR Corporation is incorporated in the state of Maryland and has its corporate headquarters and principal place of business in the state of Ohio. NCR Corporation is engaged in the manufacturing and sale of business equipment and machines, including point-of-sale terminals (computerized cash registers), automatic bank teller machines, mainframe computers and personal computers.

2. During the periods in question, NCR Corporation had 17 manufacturing facilities throughout the world, each of which it operated directly or through a subsidiary. Twelve of these facilities are located in the United States, and one each is located in Japan, Canada, Scotland, Germany and Mexico. Approximately 70% of all products sold by petitioner are manufactured in the United States and shipped overseas.

3. During each year in question, NCR Corporation transacted business through the selling of its products and related supplies and services at wholesale and retail levels partly within and partly outside the state of New Mexico. The property, payroll and sales of: a) NCR Corporation

in New Mexico; b) NCR Corporation within the United States; and c) NCR's relevant foreign subsidiaries are found in paragraphs 34, 35 and 37, respectively, below.

4. During the relevant periods, NCR Corporation conducted business in all fifty states. NCR Corporation wholly owns approximately ten active domestic subsidiaries. The domestic subsidiaries engaged in a wide range of activities, including but not limited to the following:

NCR Comten	Computer Networking Systems
Applied Digital Data Systems	TTY CTR Manufacturing
NCR International	Holding Company of Approximately 50% of Foreign Subsidiary Stock
NCR Credit Corp.	Financing Purchases by NCR Customers
NCC Leasing, Inc.	Leasing Equipment
NCR Egypt, Inc.	Operates Egypt Branch
Overseas Trading Corp.	Software Distributor in Brussels, Belgium
ATM Services, Inc.	Servicing of ATM's
Information Imaging	Computer Generated Printed & Microfilm Output
NACAR	Rental Property

5. Each year in question NCR Corporation filed returns with and paid taxes to the state of New Mexico on a federal consolidated basis in conformance with Section 7-2A-8.4 NMSA 1978. NCR Corporation included in each of these consolidated returns all its domestic subsidiaries, including but not limited to the subsidiaries described in paragraph 4, above. All the companies included in the consolidated group operate together as a fully-integrated unitary business and in all respects are unitary with the business any of them transact in New Mexico.

6. NCR Corporation conducts its business in foreign countries directly and through its foreign subsidiaries and branches, through the ownership of stock in foreign subsidiaries, through exploitation of patents and license agree-

ments with foreign subsidiaries and through loan agreements. NCR Corporation has approximately 75 foreign subsidiaries and 18 foreign branches which conduct business in approximately 150 countries worldwide. NCR Corporation's foreign subsidiaries and branches are, primarily, engaged in marketing and operate for the purpose of selling, marketing and distributing the products manufactured by NCR Corporation. Except as to its Japanese subsidiary (in which NCR Corporation owns approximately 70% of the outstanding stock) and certain other smaller subsidiaries, NCR Corporation owns 100% of the stock of its foreign subsidiaries.

7. The operation of NCR Corporation's foreign subsidiaries and its foreign branches is nearly identical. The foreign subsidiaries use the same accounting policies as the foreign branches and the rest of the Corporation. The only difference between the foreign subsidiaries and the foreign branches is that the subsidiaries are separate corporations while the branches are divisions of NCR Corporation. All significant operating decisions for both the branches and subsidiaries are made at the Corporate Headquarters located in Dayton, Ohio. The decision to conduct business in a foreign country through a subsidiary corporation rather than a branch office is not always within the exclusive control of NCR Corporation, but may be dictated by the laws and policies of that foreign country.

8. From a management perspective, the different organizational and geographic forms in which business is conducted make very little practical difference, whether domestically or internationally or whether through a division, branch or subsidiary corporation. NCR Corporation operates them all through a centralized accounting system, a centralized cash management system and a centralized budgeting process. There is a substantial flow of goods between NCR Corporation and its domestic and foreign subsidiaries and branches; all NCR Corporation's foreign sales are conducted through its foreign subsidiaries and foreign branches. The business conducted by NCR Cor-

poration throughout the world, both directly and through its domestic and foreign subsidiaries, is a single, integrated unitary business. All the foreign subsidiaries are unitary with NCR Corporation and the federal consolidated group. NCR Corporation contends that its Subpart F Income is not business income under Section 7-4-2(A) NMSA 1978 and is not apportionable under Section 7-4-10. With respect to the disputed foreign dividends, foreign royalties and foreign interest income, NCR Corporation contends that, notwithstanding the following sentence, said income is not apportionable under Section 7-4-10 for both constitutional and statutory reasons. NCR agrees that said dividends, royalties and interest arise from transactions and activities in the regular course of NCR's trade or business, including from tangible and intangible property, the acquisition and management of which constitute integral parts of NCR's regular trade or business operations.

9. The operating income from the foreign branches is included in NCR Corporation's federal taxable income. Since these foreign branches are part of NCR Corporation, the Internal Revenue Service requires their income and or loss to be included by NCR Corporation when calculating its federal taxable income. NCR Corporation does not contest any aspect of New Mexico's taxation of this branch income because in its view, New Mexico, in applying its apportionment formula, properly included all factors which gave rise to the branch income.

10. From its foreign subsidiary corporations, NCR Corporation receives patent royalty income, interest income and dividend income. Included in NCR Corporation's federal taxable income are the royalties, interest and dividends received by NCR Corporation from its foreign subsidiaries. The foreign subsidiaries, themselves, do not pay U.S. income tax.

11. In conducting its worldwide business, NCR Corporation develops, acquires, owns and uses patents and

patent rights, both in the United States and in foreign countries. In addition, NCR Corporation registers patents and licensing agreements in foreign countries. Pursuant to those patent registration and licensing agreements, NCR Corporation grants to its foreign subsidiaries the right to manufacture and sell business machines and equipment patented by NCR Corporation and NCR Corporation receives royalty income from its foreign subsidiaries. The foreign royalty payments made to NCR Corporation by its foreign subsidiaries are based upon the amount of sales by these subsidiaries in foreign countries.

12. NCR Corporation provides its foreign subsidiaries with capital; manufactured products; plant design; operations, service and sales training; and other support. The foreign subsidiaries incur payroll and property expenses in order to generate sales of NCR Corporation's products. When NCR Corporation's foreign subsidiaries pay royalties to NCR Corporation, the foreign country where this income is earned by NCR Corporation has the right to tax NCR Corporation on the gross amount of the royalties paid. When this right is exercised, it is usually accomplished through a withholding tax mechanism, whereby NCR Corporation's tax liability is paid over by the foreign subsidiary to the foreign country on behalf of NCR Corporation. Under contracts pursuant to which royalty payments are made, the royalty payments from foreign subsidiaries must be made to NCR Corporation even if such subsidiaries are incurring losses. The rate of tax imposed by the foreign country upon NCR Corporation is usually determined by a treaty between the United States and that foreign country, and, if there is no tax treaty, then under the laws of the foreign country.

13. NCR Corporation also receives interest payments from foreign sources. There are four types of interest payments received by NCR Corporation. These payments consist of interest from loans to its foreign subsidiaries; interest from its foreign subsidiaries for financing receivables; interest income pursuant to Section 904(d) of the

Internal Revenue Code of 1986; and interest received from unrelated third parties, namely banks where NCR Corporation itself has funds on deposit within foreign countries. NCR Corporation registers certain foreign loan agreements in foreign countries. NCR Corporation's interest income from foreign sources is also subject to the foreign withholding tax mechanisms in the same manner as the royalty payments. Under NCR Corporation's loan agreements interest must be paid to NCR Corporation by its foreign subsidiaries even if the foreign subsidiaries are incurring losses.

14. NCR Corporation receives actual dividends from its foreign subsidiaries. NCR Corporation's foreign subsidiaries from time to time declare and pay actual dividends from earnings to shareholders, principally NCR Corporation. NCR Corporation's dividends from foreign sources are also subject to the foreign withholding tax mechanisms in the same manner as the royalty payments. In addition, NCR Corporation is required to include "deemed dividends" in its computation of federal taxable income (these are generally referred to as Subpart F Income). The Subpart F provisions, set forth in Sections 951, *et seq.*, of the Internal Revenue Code, require NCR Corporation to include in its federal gross income items which it has not actually received but is rather deemed to have received as a result of being a U.S. shareholder of a controlled foreign corporation. The Subpart F Income deemed to have been received by NCR Corporation is attributable to various items set forth in Sections 951, *et seq.*, of the Internal Revenue Code and is measured by certain types of undistributed income earned by the foreign subsidiaries.

15. The gross amount of the payments received by NCR Corporation in the form of royalties, interest and dividends is gross income earned directly by NCR Corporation and was for all relevant periods treated as such in each of the foreign jurisdictions in which NCR Cor-

poration and its subsidiaries conduct business. Consequently, NCR Corporation is subject to the taxing jurisdiction of each of the host countries as to this income. Most foreign countries which tax this income do so by imposing a flat tax upon the gross amount of the royalties, interest and dividends received by NCR Corporation from its subsidiaries in the foreign countries. These countries collect the tax by requiring the payor to withhold and pay over the amount of NCR Corporation's tax liability. The various foreign countries' withholding tax rates applicable to NCR Corporation's royalties, interest and dividends range from zero percent (0%) to forty percent (40%) of the gross amount of the payment. The tax is imposed by the laws of the foreign country and the rate is determined by treaty or, in the event there is no such treaty, then by the laws of the foreign country. These taxes are completely unrelated to the income taxes paid by the foreign subsidiaries on their operating income.

16. In 1983 there were six foreign subsidiaries of NCR Corporation which made either interest, royalty or dividend payments to NCR Corporation and incurred losses. All six made interest payments totaling $831,623. Four of these six also made royalty payments to NCR Corporation totaling $25,108. None made dividend payments. In 1986 there were five foreign subsidiaries of NCR Corporation which made either interest, royalty or dividend payments to NCR Corporation and incurred losses. All five made interest payments totaling $203,253. None of these companies made any royalty or dividend payments to NCR Corporation that year. [On or before September 28, 1990 NCR will provide TRD any proposed stipulation and supporting schedules relating to dividend, interest and royalty paying foreign subsidiaries which incurred losses in the years 1981, 1982, 1984, 1985 and 1987. The form of the proposal will follow the form set forth above in this paragraph. These numbers will be subject to prompt audit by TRD. If TRD does not receive such a proposal by September 28, 1990, the record

in this case will be closed on this issue. If TRD does receive a timely proposal, on or before October 15, 1990, TRD will stipulate to facts on this issue that are supported by numbers TRD can confirm.]

17. The New Mexico Taxation and Revenue Department (TRD) is the agency of the state of New Mexico responsible by law for the collection of taxes and enforcement of the state's tax laws.

18. On October 21, 1985 TRD issued Assessment Number 5909 assessing NCR Corporation a total of $23,071.17 in taxes due for 1982 ($16,049.51 in tax plus penalty of $1,604.95 and interest of $5,416.71 to June 15, 1985).

19. On October 26, 1985 TRD issued Assessment Number 5929 assessing NCR Corporation a total of $24,469.01 in taxes due for 1983 ($19,005.05 in tax plus penalty of $1,900.51 and interest of $3,563.45 to June 15, 1985).

20. On October 29, 1985 TRD issued Assessment Number 5932 assessing NCR Corporation a total of $7,677.41 in taxes due for 1981 ($4,905.69 in tax plus penalty of $490.57 and interest of $2,281.15 to June 15, 1985).

21. On November 18, 1985 NCR Corporation filed a timely protest of Assessment Numbers 5909, 5929 and 5932.

22. On January 25, 1990 TRD issued Assessment Number 7846 assessing NCR Corporation the following taxes and interest for each of the following years:

	Tax	Interest	Total
1984	$ 14,200.18	$ 10,472.63	$ 24,672.81
1985	$ 14,520.03	$ 8,530.52	$ 23,050.55
1986	$ 32,032.00	$ 14,014.00	$ 46,046.00
1987	$323,712.00	$ 93,067.20	$416,779.20
TOTAL:	$384,464.21	$126,084.35	$510,548.56

23. On February 23, 1990 NCR Corporation filed a timely protest of Assessment Number 7846.

24. The protests of assessments 5909, 5929, 5932 and 7846 have been consolidated and will be heard together by the administrative hearing officer.

25. Interest on all taxes assessed continues to run at the rate set by New Mexico law (currently 15 percent per year).

26. NCR Corporation's position is that (i) its disputed foreign source income (royalties, interest and dividends) is neither taxable nor apportionable by New Mexico because that income is earned by NCR Corporation in foreign countries where such income is subject to an unapportioned tax and because that income is not attributable to New Mexico, and (ii) its Subpart F Income may not be taxed by New Mexico and may not be subjected to apportionment by the state of New Mexico. If it held that this foreign source income is taxable by New Mexico and therefore apportionable, then it is NCR Corporation's position that the Due Process, Equal Protection and Commerce Clauses of the United States Constitution are violated if the factors which gave rise to the income are not included in the apportionment factors. Finally, NCR Corporation asserts that for tax years 1984 and 1985 the statute of limitations expired before the assessments were issued.

27. TRD's position is that all the unitary business income (from both domestic and foreign sources) and the Subpart F Income of NCR Corporation and the members of its consolidated group are properly includable in NCR Corporation's New Mexico apportionable income and subject to tax by this state. TRD also asserts that its use of apportionment factors based solely on NCR Corporation's consolidated group's factors does not violate the United States Constitution or state or federal law. Finally,

TRD claims that, under Section 7-1-18(D) NMSA 1978, the statute of limitations had not expired before the assessments for tax years 1984 and 1985 had issued. TRD agrees that $70,040,627 of Section 78 foreign dividend gross-up was mistakenly reported on Line 8 of Schedule C of NCR Corporation's 1982 United States Corporate Income Tax Return Form 1120 as Subpart F Income and all relevant entries for 1982 in this stipulation have been adjusted by TRD to reflect the proper reporting of this income. TRD also agrees that all penalties assessed (for tax years 1981, 1982 and 1983) will be abated.

28. Upon audit the state of New Mexico disallowed all of the income adjustments which were claimed by NCR Corporation with the exception of Section 78 gross-up. Those income adjustments included NCR Corporation's reduction of federal taxable income by the amount it actually received from foreign source royalty, interest and dividend payments and the amount it was deemed to have received as Subpart F Income. New Mexico is not attempting to tax the operating income of NCR's foreign subsidiaries, but is attempting to tax the income received by NCR Corporation from the payment to it by its foreign subsidiaries of royalties, dividends and interest and its Subpart F Income.

29. The foreign-source dividends, interest and royalties earned by NCR Corporation from its unitary foreign subsidiaries for each of the years 1981 through 1987 are as follows:

"FOREIGN SOURCE" GROSS INCOME RECEIVED BY PARENT (NCR CORPORATION)

1981	
Dividends	$ 34,416,543
Interest	$ 21,730,821
Royalties	$ 40,590,222
TOTAL:	$ 96,737,586
1982	
Dividends	$ 35,214,185
Interest	$ 28,320,913
Royalties	$ 47,897,917
TOTAL:	$111,433,015
1983	
Dividends	$ 45,963,133
Interest	$ 19,445,024
Royalties	$ 54,464,120
TOTAL:	$119,872,277
1984	
Dividends	$ 50,167,524
Interest	$ 16,157,574
Royalties	$ 73,833,474
TOTAL:	$140,158,572
1985	
Dividends	$ 63,994,155
Interest	$ 7,836,796
Royalties	$ 86,296,270
TOTAL:	$158,127,221
1986	
Dividends	$ 73,289,419
Interest	$ 11,765,099
Royalties	$100,039,780
TOTAL:	$185,094,298
1987	
Dividends	$246,229,126
Interest	$ 5,458,622
Royalties	$149,774,394
TOTAL:	$401,462,142

30. NCR Corporation's total gross foreign source income on which foreign taxes were and were not actually withheld, the amount of foreign withholding taxes paid on NCR's behalf by its foreign subsidiaries, the total Foreign Tax Credit taken by NCR Corporation on its United States Corporate Income Tax returns (Section 901 of the Internal Revenue Code), and the amount of this U.S. tax credit attributable to foreign taxes actually paid by NCR Corporation's foreign subsidiaries on NCR's behalf for each year are as follows:

FOREIGN TAX DATA

	NCR's Gross Foreign Source Income on Which *No* Foreign Tax Was Withheld	NCR's Gross Foreign Source Income on Which Foreign Tax Was Withheld	Total Foreign Withholding Tax Paid for NCR by its Subsidiaries	NCR's Total United States Income Tax Foreign Tax Credit	Tax Credit Attributable to Foreign Taxes Paid by Foreign Subsidiaries
1981					
Dividends	$ 4,032,324	$ 30,384,219	$ 3,653,849		
Interest	$ 4,526,192	$ 17,204,629	$ 4,379,925		
Royalties	$ 27,594,277	$ 12,995,945	$ 1,463,093		
TOTAL:	$ 36,152,793	$ 60,584,793	$ 9,496,867	$ 43,656,914	$ 9,858,627
1982					
Dividends	$ 15,533,955	$ 19,680,230	$ 3,901,911		
Interest	$ 13,327,390	$ 14,993,523	$ 3,967,400		
Royalties	$ 29,637,674	$ 18,260,243	$ 1,840,217		
TOTAL:	$ 58,499,019	$ 52,879,996	$ 9,709,528	$110,391,259	$10,160,348
1983					
Dividends	$ 21,181,884	$ 24,781,249	$ 4,726,496		
Interest	$ 14,295,341	$ 5,149,683	$ 1,675,106		
Royalties	$ 21,856,328	$ 32,607,792	$ 2,380,722		
TOTAL:	$ 57,333,553	$ 62,538,724	$ 8,782,324	$ 62,959,190	$ 9,505,881

1984					
Dividends	$ 12,614,739	$ 37,552,785	$ 5,886,324		
Interest	$ 12,013,508	$ 4,144,066	$ 1,477,900		
Royalties	$ 45,162,055	$ 28,671,419	$ 2,753,448		
TOTAL:	$ 69,790,303	$ 70,368,270	$10,117,672	$ 84,011,578	$11,017,045
1985					
Dividends	$ 10,346,048	$ 53,648,107	$ 7,012,304		
Interest	$ 5,776,154	$ 2,060,642	$ 1,163,772		
Royalties	$ 46,260,141	$ 40,036,129	$ 3,318,157		
TOTAL:	$ 62,382,343	$ 95,744,878	$11,494,233	$147,389,608	$12,230,536
1986					
Dividends	$ 11,985,830	$ 61,303,589	$ 8,356,901		
Interest	$ 9,811,822	$ 1,665,370	$ 361,892		
Royalties	$ 57,313,800	$ 42,725,980	$ 3,455,604		
TOTAL:	$ 79,112,052	$105,694,939	$12,174,397	$ 83,805,470	$12,432,825
1987					
Dividends	$ 10,988,279	$235,240,847	$28,213,145		
Interest	$ 3,856,577	$ 1,602,045	$ 404,848		
Royalties	$ 91,631,669	$ 58,142,725	$ 4,141,767		
TOTAL:	$106,476,525	$294,985,617	$32,780,715	$248,512,105	$33,216,735

31. The amount of "gross-up" under Section 78 of the United States Internal Revenue Code allowed by TRD as a deduction from apportionable income in the following years is as follows:

GROSS-UP

1981	$ 27,934,332
1982	$ 91,828,291
1983	$ 45,777,859
1984	$ 61,647,910
1985	$122,888,999
1986	$ 58,425,843
1987	$205,293,818

32. The state of New Mexico is also including in NCR Corporation's apportionable income amounts deemed as Subpart F Income in the following amounts for each year:

SUBPART F INCOME

1981	$ 3,063,608
1982	$ 61,471,050
1983	$ 16,274,706
1984	$ 19,783,668
1985	$ 87,301,962
1986	$ 9,325,013
1987	$122,241,498

33. If NCR Corporation prevails in its primary position, some or all of the income specified in paragraphs 29 and 32 will have to be subtracted from the total annual apportionable income set forth in this paragraph. If TRD's position is sustained in full, then NCR Corporation's total apportionable income for purposes of apportionment to and taxation by New Mexico (calculated by starting with Federal Taxable Income from line 30 Form

1120, which includes the income set forth in paragraphs 29 and 32 of this Stipulation, and excluding the gross-up specified in paragraph 31) for each year is as follows:

NCR's NET APPORTIONABLE INCOME
(INCLUDING ALL DISPUTED FOREIGN SOURCE AND SUBPART F INCOME)

1981	$153,116,607
1982	$214,663,629
1983	$277,399,602
1984	$316,859,147
1985	$335,401,046
1986	$147,573,952
1987	$489,545,492

34. NCR Corporation's and its entire federal consolidated group's payroll, property and sales in New Mexico for each year are as follows:

APPORTIONMENT
FACTORS-NUMERATOR-NEW MEXICO

	Payroll	Property	Sales
1981	$1,774,178	$4,188,760	$10,125,264
1982	$2,027,562	$4,539,852	$12,252,046
1983	$2,168,917	$4,303,429	$13,220,530
1984	$2,063,525	$3,568,104	$13,657,684
1985	$2,197,202	$4,450,091	$12,809,472
1986	$2,415,845	$4,958,596	$13,767,421
1987	$2,384,653	$4,436,036	$ 9,066,316

35. NCR Corporation's and its entire federal consolidated group's payroll, property and sales (to be included in the denominator for calculation of the respective New Mexico apportionment factors for each year if the Taxa-

tion and Revenue Department's position is correct in its entirety), including (in the "sales" column) the income specified in paragraph 29 of this Stipulation, are set forth below (in this paragraph 35). If NCR prevails in its protest, the amount of some or all of the payroll, property and sales numbers for each respective year will have to be increased.

APPORTIONMENT FACTORS-DENOMINATOR
FEDERAL CONSOLIDATED EVERYWHERE

	Payroll	Property	Sales
1981	$ 760,371,034	$1,697,142,638	$2,190,686,114
1982	$ 790,035,516	$1,756,345,462	$2,739,704,257
1983	$ 861,962,023	$1,767,924,904	$2,660,154,707
1984	$ 847,483,268	$1,788,931,289	$3,058,101,729
1985	$ 995,063,950	$1,912,333,615	$3,263,359,784
1986	$1,081,681,303	$1,905,794,350	$3,252,504,941
1987	$1,126,931,270	$1,979,005,806	$4,004,618,027

36. In the event the Taxation and Revenue Department's position is sustained in its entirety, then NCR's tax liability to the state of New Mexico (exclusive of interest on the liability) is calculated as follows:

	NCR's Net Apportionable Income (¶ 33)		NCR's Apportionment Factor (the average of the ratios in ¶¶ 34 & 35)		NCR's N.M. Taxable Income	NCR's N.M. Tax Liability
1981	$153,116,607	x	0.3141%	=	$ 480,939	$19,238
1982	$214,663,629	x	0.3208%	=	$ 743,607	$29,744
1983	$277,399,602	x	0.3307%	=	$ 917,360	$44,033
1984	$316,859,147	x	0.2965%	=	$ 939,487	$45,095
1985	$335,401,046	x	0.2820%	=	$ 945,831	$45,400
1986	$147,573,952	x	0.3023%	=	$ 446,116	$21,414
1987	$489,545,492	x	0.2207%	=	$1,080,427	$62,112

37. The total annual payroll, property and sales of NCR Corporation's foreign subsidiaries which paid royalties, interest or dividends to NCR are:

RELEVANT FOREIGN SUBSIDIARIES' PAYROLL, PROPERTY AND SALES

	Payroll	Property	Sales
1981	$463,354,241	$1,157,487,446	$1,469,269,547
1982	$406,853,477	$1,052,926,261	$1,465,497,507
1983	$420,096,582	$1,001,081,459	$1,561,878,057
1984	$387,405,569	$ 986,672,187	$1,633,510,398
1985	$420,680,964	$1,036,141,621	$1,838,679,888
1986	$560,495,875	$1,156,533,955	$2,308,742,008
1987	$658,152,879	$1,310,252,532	$2,815,785,020

38. The total annual payroll, property and sales of 1) NCR Corporation's foreign subsidiaries which paid royalties, interest or dividends to NCR (from paragraphs 37), *plus* 2) NCR's United States federal consolidated group (from paragraph 35) are:

	Payroll	Property	Sales
1981	$1,223,725,275	$2,854,630,084	$3,659,955,661
1982	$1,196,888,993	$2,809,271,723	$4,205,201,764
1983	$1,282,058,605	$2,769,006,363	$4,222,032,764
1984	$1,234,888,837	$2,775,603,476	$4,693,612,127
1985	$1,415,744,914	$2,948,475,236	$5,102,039,672
1986	$1,642,177,178	$3,062,328,305	$5,561,246,949
1987	$1,785,084,149	$3,289,258,338	$6,820,403,047

39. If the Taxation and Revenue Department prevails in part and all the disputed income is included in the apportionable tax base and if NCR Corporation prevails in part and the property, payroll and sales of the relevant subsidiaries are included in the apportionment factors, then NCR's tax liability (exclusive of interest on the lia-

bility) to the state of New Mexico is calculated as follows:

	NCR's Net Apportionable Income (¶ 33)	x	NCR's Foreign Factor Representation in Apportionment Factors (the average of the ratios in ¶¶ 34 & 38)	=	NCR's N.M. Taxable Income	NCR's N.M. Tax Liability
1981	$153,116,607	x	0.1894%	=	$290,003	$11,600
1982	$214,663,629	x	0.2075%	=	$445,427	$17,817
1983	$277,399,602	x	0.2126%	=	$589,752	$28,308
1984	$316,859,147	x	0.1955%	=	$619,460	$29,734
1985	$335,401,046	x	0.1857%	=	$622,840	$29,896
1986	$147,573,952	x	0.1855%	=	$273,750	$13,140
1987	$489,545,492	x	0.1338%	=	$655,012	$33,921

40. The gross revenue income and the net income before taxes of all of NCR Corporation's foreign subsidiaries which paid royalties, dividends or interest to NCR each year is:

RELEVANT FOREIGN SUBSIDIARIES' INCOME

	Gross Revenue	Net Income Before Taxes
1981	$1,469,269,547	$169,020,048
1982	$1,465,497,507	$208,654,641
1983	$1,561,878,057	$186,243,865
1984	$1,633,510,398	$232,072,220
1985	$1,838,679,888	$238,480,034
1986	$2,308,742,008	$349,187,493
1987	$2,815,785,020	$468,960,225

DISCUSSION AND ANALYSIS

A. *Background*

This case presents for decision complex issues concerning how the income of a multistate and multinational corporation can be apportioned among the various states. In its protest, NCR has challenged the imposition of New Mexico's corporate income tax upon a proportionate share of NCR Corporation's income received in the form of royalties, interest and dividends from its foreign subsidiaries. NCR Corporation argues that the Foreign Commerce Clause of the United States Constitution acts as an absolute bar to New Mexico's inclusion of NCR's foreign-sourced income in the New Mexico apportioned tax base. In the alternative, NCR posits that the method by which New Mexico imposes its tax is unconstitutional under the Commerce Clause and the Due Process Clause of the United States Constitution and the Due Process Clause of the New Mexico Constitution. A third issue concerns New Mexico's treatment of what is called Subpart F income. Finally, NCR Corporation asserts that, should it prevail on its other arguments, its assessed tax liability would be reduced sufficiently (to where it would not be considered to have underreported its corporate income tax liability by more than 25%) so as to bar the Department's assessment for tax years 1984 and 1985, pursuant to the statute of limitations at Sections 7-1-18(A) and (D) NMSA 1978. No penalty on any of the assessments is at issue as the Department has agreed to abate any penalty assessed.

In order to provide a background for the discussion of these issues, a brief review of the interrelationship between the Foreign Commerce Clause, the Due Process Clause and the state's ability to tax income generated in foreign commerce in the context of the application of the unitary business principle will be reviewed. Additionally, New Mexico's statutory method for calculating corporate income

taxes under the Uniform Distribution of Income for Tax Purposes Act (UDITPA) Sections 7-4-1 to 7-4-21 NMSA 1978 will also be reviewed.

It is fundamental under both the Due Process and Commerce Clauses of the Constitution that a state may not, when imposing an income-based tax, tax value earned outside of its borders. *See, Asarco, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982). When dealing with income that has been earned by a multistate and multinational taxpayer, determining what income has been earned by that taxpayer within a particular state can be extremely complicated and has generated a significant amount of constitutional litigation in the U.S. Supreme Court. *See, e.g., Asarco; Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983); *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425 (1980); *F.W. Woolworth Co. v. Taxation and Revenue Department*, 458 U.S. 354 (1982); *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980); *Moorman Manufacturing Co. v. Baer*, 437 U.S. 267 (1978), and many others. Because of the difficulty of precisely measuring a state's properly apportioned portion of a multistate or multinational taxpayer's income, the Supreme Court has long held that the Constitution imposes no single formula on the states, *Wisconsin v. J.C. Penney*, 311 U.S. 435, 445 (1940), and has placed upon a taxpayer challenging a state's formula, the burden of showing by clear and cogent evidence that a state tax results in the taxation of extraterritorial values. *Exxon Corporation, supra*, 447 U.S. at 221. Historically, states attempted to account for their share of taxable income based upon systems of separate accounting whereby a company's income earned within the geographical boundaries of the state was determined based on formal corporate entities or on an attempt to segregate transactions conducted within the state. This methodology, called separate accounting, has largely been abandoned in modern times because separate accounting

was subject to manipulation and imprecision and often ignored or captured inadequately the many subtle and often unquantifiable transfers of value that take place among the components of a large, complex enterprise. *See, generally, Mobil Oil Corp.*, 445 U.S. at 438-439. As a result of the inadequacy of the separate accounting concept, the unitary business concept evolved. The unitary business principle generally disregards territorial boundaries and corporate structure issues. The unitary concept requires viewing a business enterprise as a single unit irrespective of whether the enterprise crosses geographic boundaries or its business is conducted through separate corporate entities. Once the scope of the unitary business is defined, the taxable income of the total unitary enterprise is determined and various apportionment formulas may be applied to approximate the unitary business income which is reasonably related to the business's activities conducted within the taxing jurisdiction based on various objective measures of the taxpayer's activities both within and without the taxing jurisdiction. *See, e.g., Moorman Manufacturing Co. v. Baer*, 437 U.S. 267 (1978). The Supreme Court long ago upheld the constitutionality of the basic unitary business concept. *See, e.g., Hans Rees' Sons, Inc. v. North Carolina, ex rel., Maxwell*, 283 U.S. 123 (1931); *Bass, Ratcliff and Gretson, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924); *Underwood Typewriter Company v. Chamberlain*, 254 U.S. 113 (1920). More recently, the U.S. Supreme Court has noted that "the linchpin of apportionability in the field of state income taxation is the unitary business principle." *Mobil Oil Corp.*, 445 U.S. at 439. In other words, it is the unitary business principle which provides the constitutional basis for the use of an apportionment formula by the states to apportion to the states their appropriate share of corporate income.

The most common apportionment formula is the three-factor apportionment formula found in the UDITPA

which, with minor variations, over half of the states, including New Mexico, have adopted. *See*, Sections 7-4-10 through 7-4-18 NMSA 1978. The UDITPA formula requires the creation of three fractions: 1) the value of a corporation's property in a given state (the property numerator) divided by its property everywhere (the property denominator); 2) the corporation's payroll in the state (the payroll numerator) divided by its payroll everywhere (the payroll denominator); 3) and the taxpayer's sales in the state (the sales numerator) divided by its sales everywhere (the sales denominator). These three fractions are then added together and divided by three to arrive at a fraction or multiplier which is applied to the corporation's total apportionable income to arrive at the portion which can be taxed by the given state.

The unitary business concept has been implemented somewhat differently in various states with regard to the division of income of multinational operations. For instance, California has adopted what is called "worldwide combined reporting," which involves the combination of both domestic (U.S.) corporations, as well as foreign corporations, so long as they constitute part of a unitary business. New Mexico law, Section 7-2A-8.3(B) NMSA 1978 prohibits worldwide combined reporting and does not include foreign corporations in its definition of the reporting taxpayer. Rather, under New Mexico's system,[1] the reporting taxpayer is the federal consolidated group, in this instance, NCR and its domestic subsidiaries, but excluding NCR's foreign subsidiaries. Under this system during the years in question, New Mexico calculated NCR's corporate income tax by the following method: 1) start with federal taxable income of the federal consolidated group; 2) deduct foreign dividend gross-up, income from United States obligations and "nonbusiness" income allocated to other

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[1] Systems like New Mexico's have been characterized as a hybrid system. *See, Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 at 168, n. 5 (1983).

states; 3) apportion this total apportionable income in accordance with the three-factor formula specified by UDITPA to determine New Mexico's apportioned share; and 4) apply the tax rate to this New Mexico taxable income to arrive at the tax due. *See,* Sections 7-2A-2(C), 7-2A-2(J)(2), 7-2A-8, 7-2A-3, 7-4-10 through 7-4-18 NMSA 1978 as in effect for the tax years 1981 through 1987.

B. *Application of the Foreign Commerce Clause.*

The primary issue presented is whether New Mexico may impose its corporate income tax upon a proportionate share of NCR Corporation's income received in the form of royalties, interest and dividends from its foreign subsidiaries. NCR Corporation argues that the Foreign Commerce Clause of the United States Constitution precludes New Mexico's tax.

Under New Mexico's "hybrid" scheme for corporate income tax reporting, which defines the taxpayer as the federal consolidated group, New Mexico is not seeking to directly tax the income of any of NCR Corporation's foreign subsidiaries. Rather, New Mexico seeks to tax an apportioned share of the U.S. parent corporation's income which it received in the form of royalties, interest and dividends from its unitary foreign subsidiaries.

It is beyond cavil that the foreign source of the income itself does not create a *per se* bar to state taxation. *See, Mobil Oil Corp. v. Comm'r of Taxes of Vermont,* 445 U.S. 425 (1980) at 439-440. Likewise, it is not disputed that once it is established that a unitary business exists, states may tax a proportionate share of the business's income, providing that that tax imposition meets certain constitutional standards. It is the application of those standards to the income in question which is in dispute. There is no dispute as to the amount, character or source of the income at issue.

The Foreign Commerce Clause is found in art. I, § 8, cl. 3 of the United States Constitution. It provides that "Congress shall have the power to regulate commerce with the foreign nations . . ."

The factual predicate for NCR's contention that New Mexico's attempt to tax NCR's royalty interest and dividend income from its foreign subsidiaries is found in paragraphs 10, 11, 12, 13, 14 and 15 of the findings of fact. These paragraphs describe the nature of NCR Corporation's income from its foreign subsidiaries and the methods by which they are taxed. Paragraph 15 is of particular interest because it contains the kernel of NCR's argument. It was agreed by the parties that the royalties, interest and dividends received by NCR Corporation from its foreign subsidiaries were treated as gross income of NCR Corporation, thus subjecting NCR Corporation to the taxing jurisdiction of each of the host countries with regard to this income. Most of the countries which tax this income do so by imposing a flat tax upon the gross amount of royalties, interest and dividends received by NCR Corporation and the tax is generally collected by requiring the subsidiary paying the royalties, interest or dividends to withhold and pay over the amount of NCR Corporation's tax liability. The withholding tax applicable to NCR's foreign source income ranges from 0% to 40%, depending on tax treaties or the laws of the host foreign country. This withholding tax imposed upon NCR Corporation is completely separate and apart from any tax the foreign governments may impose directly upon the foreign subsidiaries upon their income.

Based upon the fact that 100% of NCR's foreign source royalty, interest and dividend income is subject to the taxing jurisdiction of the foreign countries in which that dividend is earned, NCR contends that any attempt by a state to impose its tax, even on an apportioned basis, constitutes multiple taxation which is absolutely barred

under the United States Supreme Court's interpretation of the operation of the Foreign Commerce Clause in the seminal case of *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979).

Japan Line involved an attempt by the county of Los Angeles to impose property tax upon the value of cargo containers belonging to a Japanese shipping company's vessels which were present in California on the lien date for *ad valorem* property taxes. The cargo containers were used exclusively for transporting cargo in foreign commerce and, like the ships they were used in, they were owned by Japanese companies which have their place of business and commercial domicile in Japan. Underpinning the Court's decision was its recognition that with respect to *ad valorem* taxes, it was the "custom of nations" to allow the country of domicile to tax the shipping containers on their full value. *Id.* at 448.

The Court's analysis of the Foreign Commerce Clause began with its consideration of the restrictions which the Interstate Commerce Clause places upon states' ability to tax interstate commerce. When purely interstate commerce is involved, a state tax is lawful when it: 1) is applied to an activity having a substantial nexus with the taxing state; 2) is fairly apportioned; 3) is fairly related to the services provided by the state; and 4) does not discriminate against interstate commerce. *See, Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). However, when a state seeks to tax instrumentalities of foreign commerce, two additional considerations beyond those of *Complete Auto Transit* apply. "A court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the federal government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Japan Line*, 441 U.S. at 452. In applying these tests, the Court concluded that Califor-

nia's apportioned property tax resulted in actual multiple taxation and prevented the federal government from speaking with one voice with regard to its foreign relations and foreign trade. The Court thus invalidated California's tax under both of the additional foreign commerce clause considerations.

If *Japan Line* were the Supreme Court's last word on the application of the Foreign Commerce Clause to states' efforts to impose their apportioned income taxes to foreign source income, there would be no need for further analysis, and NCR would prevail upon its claim, based upon the fact that it is subject to income taxation on the foreign source income by its foreign host countries as well as in the state of New Mexico, constituting prohibited multiple taxation. *Japan Line*, however, must be read in conjunction with the Court's more recent pronouncements concerning the application of the Foreign Commerce Clause in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), which extensively analyzed the application of *Japan Line* to state taxation of corporation income. *Container* involved in [sic] the application of California's corporate franchise tax to a Delaware corporation doing business in California and which also had subsidiaries operating overseas. *Container Corporation of America* attempted to exclude from California's consideration its property, payroll and sales of its foreign subsidiary corporations in calculating California franchise tax. California employs a different corporate income taxation scheme than New Mexico's, called the worldwide combined reporting system, but both New Mexico's and California's systems rely upon the unitary business concept as the predicate for combining the incomes of all or at least a portion of the businesses which are considered unitary prior to the state's applying an apportionment formula to the income to determine its taxable share.

The Court in *Container Corporation* extensively analyzed the application of *Japan Line* to the issue of state

taxation of foreign-sourced corporation income. NCR Corporation's position that *Japan Line* continues to operate as an absolute bar to multiple taxation by both states and foreign nations of income can no longer be credibly maintained given the Court's analysis in *Container Corporation*. As in *Japan Line*, the *Container* court found that there was actual double taxation, "in the sense that some of the income taxed without apportionment by foreign nations as attributable to appellant's foreign subsidiaries was also taxed by California as attributable to the state's share of the total income of the unitary business . . ." 463 U.S. at 187. It also noted that the double taxation stems from a serious divergence in the taxing schemes adopted by the state and the foreign taxing authorities, and the taxing method adopted by the foreign authorities was consistent with accepted international practice. *Id.* at 187. The Court went on to note that,

> "Nevertheless, there are also a number of ways in which this case is clearly distinguishable from *Japan Line*. First, it involves a tax on income rather than a tax on property. We distinguish property from income taxation in *Mobil Oil Corp.*, 445 U.S. at 444-446 and *Exxon Corp.*, 447 U.S. at 228-229, suggesting that "the reasons for allocation to a single situs that often apply in the case of property taxation carry little force" in the case of income taxation. [Citation omitted]. Second, the double taxation in this case, although real, is not the "inevitable" result of the California taxing scheme [citing *Japan Line*] . . . The third difference between this case and *Japan Line* is that the tax here falls, not on the foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States.

Container Corp., 463 U.S. at 188. Finding that these distinctions added up to a "constitutionally significant

difference," the *Container* Court allowed the state's double taxation of corporate income by both foreign governments and states to stand. *Id.* at 189-197.

In applying the Court's rationale for distinguishing *Japan Line* and *Container* to the facts of this case, it is clear that the first and third bases which the *Container* Court relied upon to distinguish *Japan Line* are present in this case. Specifically, as in *Container*, this case involves a tax on income rather than the tax on property, and the tax falls here on a corporation domiciled and headquartered in the United States, rather than on the foreign owners of an instrumentality of foreign commerce. It is the second ground, whether or not multiple taxation is "inevitable" upon which NCR Corporation relies. It must be observed at this point of the analysis that in its *Container* decision, the Supreme Court gave no indication as to the weight to be accorded to each of the three factors by which it distinguished the facts in *Container* from *Japan Line*. NCR assumes that the existence of one factor, the inevitability of multiple taxation, is fatal under the Foreign Commerce Clause, but this is not at all clear from the *Container* decision.

The Court in *Container Corporation* found that actual double taxation was the result of the application of two distinct methods of allocating the income of the multinational enterprise being applied by foreign governments and by the states, and it stated whether the combination of the two methods results in double taxation is dependent solely on the facts of the individual case. *Id.* at 188. Here also, we have two different methodologies being applied. On one hand, foreign governments claim the right to tax the income at rates varying from 0% to 40%. States also assert jurisdiction to tax a proportionate share of the same income. NCR asserts that double taxation is "inevitable," thus violating the Foreign Commerce Clause in contravention of *Japan Line*, because the foreign governments claim the jurisdiction to tax NCR on 100% of its foreign source income. *See*,

Reply Brief of NCR, pp. 5-6. Any state tax imposed upon the same income "inevitably" results in double taxation. The Department argues that double taxation is not inevitable because any double taxation is the result of two different methods of taxation, and whether double taxation actually occurs is dependent on the facts of the individual case.

The Supreme Court in *Container* did not clearly explain the concept of "inevitability." In *Japan Line,* it was the custom of nations for the country of domicile to tax 100% of the value of the cargo containers. Thus, any attempt by California to impose any tax on those same containers "inevitably" resulted in multiple taxation. Here, although NCR asserts that foreign governments tax 100% of the foreign source income, the actual tax rates stipulated by the parties show that the foreign withholding taxes are imposed at rates ranging from 0% to 40%. Finding of Fact No. 15. A tax rate of zero percent sounds suspiciously like a decision to exempt entirely from taxation. Thus, unlike in *Japan Line,* it is apparently not the consistent practice, or "custom of nations" for foreign governments to tax the royalty, interest and dividend income of nondomiciliary parent corporations derived from subsidiaries domiciled in the foreign country. Because the concept of "inevitability" is so difficult to discern from the Supreme Court's decision in *Container,* a more objective basis for analyzing this issue is to examine whether under the facts of the individual case, double taxation of the income at issue is always the result. As noted above, although host foreign governments may have the jurisdiction to impose an unapportioned tax upon all of NCR Corporation's royalty, interest and dividend income, the actuality of that tax is significantly different. As set forth in the Department's answer brief at page 7, based upon the figures found in Findings of Fact 29 and 30, a significant portion of NCR's foreign source income was not taxed by any foreign country during the years in question. The amounts not taxed and the years

are set forth as follows: 1981—37%; 1982—52%, 1983—48%, 1984—50%, 1985—39%, 1986—43%, and 1987—27%. On this basis, it cannot be concluded that multiple taxation is inevitable. Rather, "whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case." *Container*, 463 U.S. at 188. Given that fact and the existence in this case of the other two distinguishing factors, distinguishing *Container* from *Japan Line*, it cannot be concluded that New Mexico's tax violates the Foreign Commerce Clause of the United States Constitution based upon the possibility of double taxation.

The second ground upon which a state tax may be prohibited under the operation of the Foreign Commerce Clause is where a state tax "may impair federal uniformity in an area where federal uniformity is essential; *Japan Line*, 441 U.S. at 448; and where the tax "prevents the federal government from speaking with one voice in international trade." *Id.* at 453. In *Japan Line*, the Court found that the California tax impaired federal uniformity in an area where federal uniformity was essential based upon the fact that both the United States and Japan had signed a customs convention on containers, providing that containers temporarily imported are free of all duties and taxes whatsoever. Thus, the convention reflected a uniform federal policy with regard to the foreign instrumentality sought to be taxed. There has been no evidence presented that New Mexico's tax on NCR's foreign source income contravenes any treaties or any other stated policy of federal uniformity with regard to state taxation of such foreign source income of a domestic corporation. With respect to preventing the federal government from "speaking with one voice on international trade," the best evidence of this is if the state tax violates some clear federal directive. There can be no doubt that if Congress wanted to put an end to this form of state taxation of the income of domestic corporations, Congress could effectively stop

it with its preemptive power to regulate commerce with foreign nations. However, Congress has not seen fit to do so. As noted in both *Mobil* and *Container*, "Congress has long debated but has not enacted legislation designed to regulate state taxation of [such] income." *Mobil*, 445 U.S. at 448. *Container*, 463 U.S. at 196-197. As in *Container*, in this instance, there are no "specific indications" through congressional enactments or federal treaties of federal intent to preempt state taxation of unitary foreign dividends, royalties or interest received by United States domestic corporations from their foreign subsidiaries.

This case is quite different than *Japan Line*, in which a state sought to impose a property tax on the property of a foreign corporation which was used exclusively in foreign commerce. In this case, New Mexico is attempting to tax its apportioned share of the income of a United States corporation which engages in unitary business with New Mexico. New Mexico is not attempting to tax any part of the income of NCR's foreign subsidiaries. It is only when NCR Corporation is actually paid a dividend, royalty or interest by one of its foreign subsidiaries that that income becomes a part of NCR's total income of which New Mexico is seeking to tax an apportioned share.

With regard to the Foreign Commerce Clause arguments raised by NCR, it is also noteworthy that this identical issue has been decided adversely to NCR Corporation by the supreme court of Minnesota. *NCR Corporation v. Comm'r of Revenue*, 438 N.W.2d 86 (MN 1989), *cert. denied*, 110 S. Ct. 144 (1989). *See also, NCR Corporation v. Comptroller of the Treasury*, 544 A.2d 764 (MD 1988).

C. *Apportionment Formula Adjustment*

In addition to its challenge of New Mexico's tax on the basis of the Foreign Commerce Clause, NCR also raised an alternative argument which challenges the fairness of New Mexico's apportionment formula with respect to NCR Corporation's foreign source income, based

upon the Due Process and Commerce Clauses. NCR argues that if New Mexico's tax scheme includes NCR Corporation's foreign source income, then its apportionment formula must take into account the factors which gave rise to the foreign source income, *e.g.*, the foreign subsidiaries' property, payroll and sales. NCR's argument may be broken down into two parts. In its first argument, NCR contends that in order to save New Mexico's apportionment formula from constitutional attack, the relevant UDITPA statutes can and must be read to require inclusion of the entire property, payroll and sales of its dividend, royalty and interest-paying foreign subsidiaries in calculating the denominator of NCR's apportionment factor. NCR contends that failure to include those factors in the denominator would render New Mexico's UDITPA formula unconstitutional. Since statutes are to be construed in such a manner as to not render them unconstitutional, if possible, New Mexico statutes should be read in such a manner as to include NCR's foreign subsidiaries property, payroll and sales in the apportionment denominator.

NCR rests its statutory construction argument upon the language which purports to include in the denominator of the property, payroll and sales factors the property, payroll and sales "everywhere." However, New Mexico statutes do not support the interpretation urged by NCR. The relevant apportionment statutes provide that:

- the denominator of the property factor is the "average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax periods." § 7-4-11;
- the denominator of the payroll factor is the "total compensation paid everywhere during the tax period" by the "taxpayer." § 7-4-14;
- the denominator of the sales factor is the "total sales of the taxpayer everywhere during the tax period." § 7-4-16.

Each of these sections explicitly refers to the property, payroll and sales "of the taxpayer." In this case, it is undisputed that the taxpayer for purposes of the imposition of New Mexico's corporate income tax is NCR Corporation's federal consolidated group, which does not include any of NCR's foreign subsidiaries. Thus, the phrase "total compensation paid everywhere" and the phrase "total sales of the taxpayer everywhere" must be construed with reference to the definition of who the taxpayer is for purposes of the calculation.

NCR has made this identical argument in two other states and has been unsuccessful in both instances. In *NCR Corporation v. Comptroller of the Treasury*, 544 A.2d at 776-778, the court rejected NCR's argument on the basis that: 1) the Maryland legislature's purposes in enacting the corporate income tax was to impose tax on as much of a corporation's net income as is constitutionally permissible; 2) the taxpayer was the federal consolidated group, which excludes foreign subsidiaries; and 3) the starting place for the tax calculation was federal taxable income, which also excludes the income of foreign subsidiaries. Thus, the Maryland Court of Appeals ruled that the Maryland statutes do not require the inclusion of NCR's foreign subsidiaries factors in the calculation of the "everywhere" denominator. The Minnesota Supreme Court arrived at the same conclusion under a similar analysis. *See NCR Corporation v. Comm'r of Revenue*, 438 N.W.2d at 88-91. Both the Maryland and the Minnesota courts declined to follow the reasoning of *Kellogg Company v. Harrington*, 343 N.W.2d 326 (NE 1984). This hearing officer concurs that the reasoning applied by the Minnesota and Maryland courts is far more persuasive than the reasoning of the Nebraska Supreme Court in the *Kellogg* case, and adopts the reasoning of the Minnesota and Maryland courts.

The second part of NCR Corporation's Due Process and Commerce Clause argument posits that inclusion of

NCR's foreign source royalty, interest and dividend income without an adjustment in the apportionment factor denominator to include the total property, payroll and sales figures of NCR's foreign subsidiaries which are responsible for generating NCR's foreign source income is unconstitutional. The United States Supreme Court has not directly spoken to the specific question presented here. In *Mobil*, the Court held that a state could, consistent with the requirements of the Due Process and Commerce Clauses, include dividends paid by unitary foreign subsidiaries in the recipient's apportionable tax base. The Court specifically eschewed, however, any ruling on whether the inclusion of the intercompany payments in apportionable income without adjustments to the apportionment formula was constitutionally permissible because *Mobil* had not raised the issue. *Mobil*, 445 U.S. 425 at 441, n. 15. NCR relies upon Justice Stevens' dissent in *Mobil* which indicates that "unless the sales, payroll and property values connected with the production of income by the dividend payor corporations are added to the denominator of the apportionment formula, inclusion of earnings attributable to those corporations in the apportionment tax base will inevitably cause Mobil's Vermont income to be overstated." *Mobil*, 445 U.S. 425, 461. However, as noted, this statement appears in Justice Stevens' dissent which was not joined by any other justice, nor has Justice Stevens' position been adopted by the Supreme Court in any subsequent cases.

NCR contends that the New Mexico taxation scheme violates the standard of fairness imposed by the Due Process and Commerce Clauses, as set forth in *Container Corporation*, 463 U.S. 159, 169. In *Container*,[2] the Supreme Court set out two standards by which the constitutional fairness of an apportionment formula may be

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[2] In *Container*, the Supreme Court upheld the application of California's corporation franchise tax under the worldwide combined reporting methodology and denied any apportionment formula adjustments.

judged. The first standard is called "internal consistency." This means that the apportionment formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed. The second and more difficult standard, "external consistency," requires that the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how the income to be apportioned is generated. It is the second standard which NCR Corporation contends the New Mexico formula violates.

At first blush, NCR's argument is compelling. It points out that, under New Mexico's hybrid system (as opposed to worldwide combined reporting), the intangible income from subsidiaries is included in the apportionable tax base of the parent corporation, yet no recognition of the subsidiaries' contributions to that income is reflected in the factors used to apportion that income because none of the foreign subsidiaries' property, payroll or sales is included in the factor denominators. NCR exemplifies this problem by contrasting its branch income to its subsidiary income. Some of NCR's foreign business is conducted through branches and some is conducted through subsidiary corporations. Under New Mexico's hybrid system, NCR branches are part of the federal consolidated reporting group upon which federal corporate income is reported. Thus NCR branch income, as well as the property, payroll and sales of NCR branches, are included in New Mexico's NCR apportionment formula. However, when NCR operates through foreign subsidiaries, although NCR's income from its foreign subsidiaries is included in federal taxable income, and therefore New Mexico apportionable income, the property, payroll and sales of the foreign subsidiaries are excluded from New Mexico's apportionment factors. NCR also attempts to show how inclusion of the foreign source interest, royalties and dividends distorts NCR's apportionable income through Tables 1 and 2 of its post-hearing brief, pages 37 and 38. These tables compare NCR's foreign source income to NCR's

totally domestic income, showing that NCR's foreign source income actually exceeded its domestic income in some of the years in question, and was, in fact, a significant portion of NCR's total apportionable income in all relevant years.

These issues warrant much closer examination, however. Although foreign source income is included in the apportionable tax base without the factors of the foreign unitary businesses being taken into account by New Mexico's apportionment formula, it is noteworthy to point out that inclusion of foreign source royalty, dividend and interest income by no means constitutes an all-inclusive inclusion of all foreign source income. It reflects only inclusion of foreign source income actually paid to the NCR parent corporation. Thus, the differential tax treatment resulting between the distinction in the form in which business is conducted, *e.g.*, branches v. subsidiaries, has a factual basis. With branch income, all income and all factors are included in the apportionment formula. With subsidiaries, not all income has been included in the income pie to be apportioned, and thus, there is at least some basis for not including the entire property, payroll and sales in the denominator of the apportionment factor. Furthermore, there is, in fact, no direct correlation between the foreign source income of NCR Corporation and the amount and extent of its subsidiary income. Interest and royalties are paid regardless of whether the subsidiary earns income or not, as a result of licensing agreements and loans between parent and subsidiary. Findings of Fact Nos. 12 and 13.

The United States Supreme Court has long recognized the complexity of fairly apportioning multijurisdictional income. As it stated in *Container Corp.*, 463 U.S. at 192, "Allocating income among various taxing jurisdictions bears some resemblance, as we have emphasized throughout this opinion, to slicing a shadow. In the absence of a central coordinating authority, absolute consistency even among taxing authorities whose basic ap-

proach to the task is quite similar, may just be too much to ask." It is precisely because of these complexities that the Supreme Court has refused to dictate to states the application of any particular apportionment formula. *Id.* at 164. Rather, a taxpayer attempting to challenge its particular apportionment formula has the burden of proving " 'by clear and cogent evidence' that the income attributed to the state is in fact 'out of all appropriate proportions to the business transacted in that state,' [*Hans Rees' Sons, Inc.*] 283 U.S. at 135, or has 'led to a grossly distorted result,' [*Norfolk & Western R. v. State Tax Commission*, 390 U.S. 317, 326]. *Moorman Mfg. Co., supra*, 437 U.S. at 274. *Container*, 463 U.S. at 170 and 180-181. The question thus presented is whether the apportioned share of NCR's income being taxed by New Mexico is "out of all appropriate proportion" or leads to "a grossly distorted result."

We have little guidance from the courts on how to measure "appropriate proportion" or "gross distortion." We do know, however, that the Supreme Court has invalidated an apportionment formula that resulted in more than 250% difference between the taxpayer's reasonable alternative formula and the state's formula. *Hans Rees' Sons, Inc. v. North Carolina, ex rel. Maxwell*, 283 U.S. 123. It is rather easy to see how a 250% difference could be considered a "gross distortion." We also have guidance that the Supreme Court did not find a 14% difference to be out of all appropriate proportion or grossly distorted. In *Container*, the Court found that such a difference was "clearly within the margin of error inherent in any method of attributing income among the components of unitary business." *Container*, 463 U.S. at 184. A careful review of the facts in this case must be engaged in to determine the amount or degree of disproportionality or distortion resulting from the application of New Mexico's apportionment formula. Before engaging in this endeavor, it must be noted that the figures used for comparison purposes for NCR Corporation, compar-

ing its U.S. v. foreign source income, is not an appropriate measure to determine the reasonableness of New Mexico's apportionment formula. In fact, the apportionment formula has not even been applied to the figures set forth in the tables in NCR's post-memorandum brief. In *Container*, the United States Supreme Court looked at the "percentage increase in taxable income" caused by the application of the challenged statutory apportionment method as opposed to an adjusted formula for apportionment. *Container*, 463 U.S. at 184. Likewise, in the case in which NCR successfully argued for an apportionment factor adjustment, *NCR Corporation v. Comptroller of the Treasury*, 544 A.2d 764, the Maryland Court of Appeals stated that "the proper focus of the inquiry for the purposes of determining apportionment distortion is on the percentage increase in taxable income apportioned to the taxing state. [sic] *Id.*, 544 A.2d at 780.

The next issue to be determined, then, is the apportionment formula to be used for comparison to the state's apportionment formula. In the *NCR Maryland* case, the Maryland Court of Appeals agreed that some factor adjustment may be warranted, but it lacked sufficient information to determine the proper methodology and remanded the case to the tax court for those calculations. With respect to the apportionment formula to be used, the court noted,

> Nonetheless, it may not be unreasonable to suggest that inclusion of subsidiaries' dividends in the apportionable income should be balanced by some changes in the formula denominator. *But the balancing should not be done by including the total property, sales and payroll values of the subsidiaries in the formula denominators.* Instead, the denominator should be modified by including only those percentages of the foreign subsidiaries' property, payroll and sales that generated the foreign subsidiary dividend income tax by Maryland.

Id. at 781 (emphasis added). Thus, the Maryland court realized that in coming up with a reasonable alternative apportionment formula, since there is no direct correlation between actual subsidiaries' income and the foreign source income paid to NCR parent corporation, the apportionment formula should take into account only the appropriate proportion of the total property, sales and payroll of the foreign subsidiary. In this case, a comparison of the amount of the total royalty, interest and dividends paid to NCR from Finding of Fact 29 with the subsidiaries' gross income by year, Finding of Fact 40, demonstrates that the subsidiaries paid NCR only a fraction of their earnings each year, thus warranting a similar approach. This comparison is contained in Table 1 of the Department's answer brief, page 16. The use of the foreign subsidiaries' gross rather than net revenues for purposes of comparison is appropriate for two reasons. First, the foreign source dividend, royalty or interest payments are made out of gross revenues because, as has been pointed out, these payments are made even if NCR may have incurred a loss. Additionally, the factors used in the apportionment formula itself for property, payroll and sales are gross figures.

In its answer brief, the Department has provided the calculations showing the difference in NCR's apportionable income using the New Mexico statutory formula and the amount calculated by applying a fractional reduction to the apportionment factors corresponding to the fraction created by comparing NCR's foreign source income to the gross revenues of the foreign subsidiaries. This was set out as Table 3 and is set forth in its entirety below.

TABLE III

	N.M. Taxable Income Per Statute	Factor Adjustment	Adjusted Factors	Adjusted N.M. Taxable Income	Difference Between Statutory & Adjusted N.M. Taxable Income
1981	$ 480,939	.065840	.3010%	$ 460,881	$ 20,058 (4%)
1982	$ 743,607	.076038	.3080%	$ 661,164	$ 82,443 (12%)
1983	$ 917,360	.076749	.3172%	$ 879,912	$ 37,448 (4%)
1984	$ 939,487	.085802	.2839%	$ 899,563	$ 39,924 (4%)
1985	$ 945,831	.086000	.2699%	$ 905,244	$ 40,587 (4%)
1986	$ 446,116	.080171	.2877%	$ 424,570	$ 21,546 (5%)
1987	$1,080,427	.142424	.2020%	$ 988,882	$ 91,545 (9%)
TOTAL:	$5,553,767			$5,220,216	$333,551 (6%)

As can be seen from this table, the difference between the income apportioned to New Mexico under the statutory formula and that apportioned to New Mexico under the adjusted formula ranges between 4 percent and 12 percent on an annualized basis, with an average differential of 6 percent for all of the years in question. This hardly rises to the level of a "grossly distorted result" which is "out of all appropriate proportion" to the business transacted in New Mexico by NCR, if we are to use the *Container* case as a guide. As noted previously, the Supreme Court in the *Container* case did not find a 14 percent distortion to be constitutionally impermissible. It thus appears the New Mexico statutory apportionment formula does a reasonable job of "slicing the shadow," and falls "clearly within the margin of error inherent in any method of attributing income among the components of [a] unitary business." *Container*, 463 U.S. at 192 and 184.

As noted above, the courts of Maryland did grant NCR Corporation some factor relief consideration (the amount in extent of which does not appear of record because the matter was remanded to a lower court for such determination). Thus, it appears that the Maryland court assumed that there was distortion of constitutional significance even though it did not have any information as to the percentage increase in taxable income apportioned to the state under the state's formula. Since the *Container* decision relied upon such calculations *before* determining whether a distortion of constitutional significance existed, the Maryland decision is not considered persuasive as to whether apportionment formula adjustment is warranted in this case. More persuasive is the reasoning of the Minnesota Supreme Court. In *NCR Corporation v. Comm'r of Revenue*, 438 N.W.2d 86 (1989), Minnesota Supreme Court examined and addressed the same claims that NCR makes in this case. It concluded that, "[T]hus we hold that NCR has failed to demonstrate by clear and cogent evidence that the relatively small re-

sulting disparity in tax fails to properly reflect how the income was generated or, that an excessive amount of that income was attributed to Minnesota under proper application of its apportionment statute to be constitutionally impermissible." *Id.* at 93. In that case, the amount of increase in the corporate taxes amounted to 23%, far larger than exists in this case. It cannot be concluded that an overall six percent differential from the application of New Mexico's apportionment formula as compared to another reasonable apportionment formula rises to the level of a constitutionally impermissible unfairness. Accordingly, neither the Commerce Clause nor the Due Process Clause requires the apportionment formula adjustments NCR requests in this case.

D. *Subpart F Income*

The next issue involves whether New Mexico may include in NCR Corporation's apportioned tax base any portion of what is called NCR Corporation's Subpart F income. New Mexico calculates its corporate income tax beginning with federal taxable income. *See,* Section 7-2A-2(C) NMSA 1978. The Internal Revenue Code, 26 U.S.C. Section 951, includes Subpart F income in the gross income of certain United States taxpayers, of which NCR Corporation is one. There is no dispute that New Mexico's statutory scheme requires the inclusion of NCR Corporation's Subpart F income in NCR's apportionable tax base for New Mexico corporate income tax purposes. NCR Corporation contends, however, that for constitutional reasons, the Subpart F income must be removed from consideration. A description of Subpart F income and the background surrounding its federal tax treatment will provide a context for the discussion of NCR's argument.

The Subpart F provisions are set out in the Internal Revenue Code, I.R.C. Section 951 through 964. Subpart F requires that United States shareholders of "controlled foreign corporations" (CFCs) to [sic] report as

income their pro rata share of the CFCs' "Subpart F income," which in this case amounted to undistributed earnings of NCR's foreign subsidiary corporations, and the foreign subsidiary corporations' increase in earnings invested in United States property. I.R.C. § 951(a).

The Subpart F provisions of the Internal Revenue Code are an exception to the general principle that shareholders are not taxable on the undistributed earnings of their corporations. The Subpart F provisions were enacted in 1962 to prevent U.S. corporations from avoiding income tax by investment in foreign subsidiaries based in tax haven countries, that is, countries with lower tax rates than the United States and with bank secrecy and corporate nondisclosure laws. *See, generally, 19th Annual Institute on International Taxation: Subpart F, Practicing Law Institute Handbook Series,* William L. Bricker, Jr., 1989; "U.S. Countermeasures Against Tax Haven Countries," 26 Columbia J Transnat'l Law 553 (1988). It was recognized that U.S. parent corporations were avoiding billions of dollars in federal tax by operating abroad through controlled foreign subsidiaries. *Id.* U.S. corporations had control of the revenues of the foreign companies and could move these funds all over the world among a network of foreign subsidiaries or even invest it in U.S. property without ever having the income subjected to U.S. taxation. *Id.* To combat this problem, Subpart F was enacted, in substance treating shareholders of controlled foreign corporations as if they had received actual dividend distributions from their CFCs, recognizing some of the subsidiary income to be income to the parent, even though no income was actually distributed.

During the tax years at issue, NCR Corporation had approximately $320 million in Subpart F income. Of this amount, approximately $180 million represents the proceeds of a loan from NCR Japan to NCR Corporation. NCR Japan was a controlled foreign corporation of NCR which had substantial undistributed earnings which the laws of Japan prohibited NCR Japan from distributing.

In order to obtain use of this money, NCR Corporation obtained a loan of $180 million from NCR Japan. The transaction is a bona fide loan, however, and NCR Corporation is repaying NCR Japan both principal and interest. The remaining portion of NCR Corporation's Subpart F income during the tax years at issue represents other undistributed income from other NCR foreign subsidiaries.

NCR raises three arguments with respect to the treatment of its Subpart F income. First, it contends that Subpart F income is hypothetical income, akin to Internal Revenue Code Section 78 "gross-up," which New Mexico does not tax. NCR contends that Subpart F income should be treated identically. The second argument raised is that New Mexico's inclusion of Subpart F income is barred by the operation of the Due Process Clause of the United States Constitution. Finally, NCR contends that a portion of its Subpart F income has already been taxed and that New Mexico is thus precluded by the Equal Protection Clause, the Commerce Clause and Article VIII, Section 1 of the New Mexico Constitution, from taxing this income a second time. These issues will be addressed in reverse order.

With respect to the third issue, the double taxation arises from the fact that during tax years 1978 through 1980, NCR contends that NCR Japan earned some of the income that was later loaned to NCR Corporation. During those years, NCR Japan and NCR Corporation filed their tax returns in New Mexico on a worldwide combined basis. Under worldwide combined reporting, the income of all the members of the combined group was included in NCR's apportionable tax base. Thus, NCR contends that some portion of its Subpart F income during the years in protest was previously taxed by New Mexico in tax years 1978 through 1980. In its answer brief, page 23, the Department concedes that this income previously taxed will be deducted from NCR's Subpart F income. However, as of the date of this decision, NCR

and the Department have not completed their calculations to determine which portion of NCR's Subpart F income must be excluded on this basis. For this reason, NCR's protest is granted as to this as yet undetermined portion of the Subpart F income. Upon conclusion of any appeal of this issue, if such appeal does not render this issue moot, and if at that time the parties are unable to agree to the amount of Subpart F income attributable to this issue, the record shall be reopened for the taking of evidence on this issue.

Next, NCR contends that the Due Process Clause of the U.S. Constitution prohibits this state from including NCR's Subpart F income in the New Mexico apportionable tax base because the income does not derive from sources within this state. NCR's argument goes like this. Although it is conceded that the federal government possesses the power, under the 16th Amendment, to tax NCR Corporation on its undistributed income earned from its investment in foreign corporations, that power is based upon the power of Congress to tax U.S. residents on their income from all sources. However, it argues that Congress's power would be circumscribed insofar as it would attempt to tax income of nonresident individual or foreign corporations, except insofar as that income derives from sources within the United States. NCR asserts that states are similarly circumscribed and are prohibited from taxing nondomiciliary foreign corporations, except on income derived from sources within the state, citing *Shaffer v. Carter,* 252 U.S. 37, 52 (1920) and P. Hartman, *Federal Limitations on State and Local Taxation,* ¶ 9:7 at 472 (1981). NCR argues that since it is a foreign corporation domiciled outside of New Mexico, New Mexico is thus circumscribed in its ability to tax NCR, and may only do so as to its income derived from sources within New Mexico. NCR argues that the undistributed income of NCR's wholly-owned foreign subsidiaries cannot possibly have its source within New Mexico, and therefore due process precludes New Mexico's tax.

This argument amounts to little more than the arguments concerning the sourcing of income presented to the U.S. Supreme Court over the many years in which the unitary business concept was evolved. As stated by the U.S. Supreme Court in *Mobil,* 445 U.S. at 439,

> The argument that the source of the income precludes its taxability runs contrary to precedent. In the past, apportionability has often been challenged by the contention that income earned in one state may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities form part of a single unitary business. [Citations omitted.]

The Court goes on to state that,

> As these cases indicate, the linchpin of apportionability in the field of state income taxation is the unitary business principle. In accord with this principle what appellant must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum products in that state.

Id. at 440. In this case, it was stipulated that there is a substantial flow of goods between NCR Corporation and its domestic and foreign subsidiaries and branches and that the business conducted by NCR Corporation throughout the world, both directly and through its domestic and foreign subsidiaries is a single, integrated unitary business. Finding of Fact No. 8. NCR Corporation conducts part of its unitary business in New Mexico, therefore New Mexico has nexus to impose its tax on an apportioned share of NCR's unitary income. New Mexico, in including NCR's Subpart F income in its total apportionable income, is not taxing value generated outside its borders. Rather, it is taxing the income which the federal govern-

ment has determined to be enjoyed by the U.S. parent of a unitary business. So long as the subsidiaries with Subpart F income are part of NCR's unitary business and the federal government requires inclusion of this Subpart F income in NCR's gross income, New Mexico, under the unitary business principle, may apportion and tax its share of that income without contravening due process.

The final argument which NCR makes with respect to its Subpart F income is that this income, as hypothetical income, may be likened to Internal Revenue Code Section 78 "gross-up" income, which New Mexico has declined to tax since the U.S. Supreme Court decision in *F.W. Woolworth Co. v. Taxation and Revenue Department,* 458 U.S. 354 (1982). For discussion purposes, it can be assumed that Section 78 gross-up is hypothetical income in the same manner that Subpart F income is. In both cases, the income is deemed income for federal taxation purposes, even though actual income may not have been paid. The Department agrees that it does not presently include Section 78 gross-up in the New Mexico apportionable tax base, but it does not concede that it is legally required to grant such treatment by any legal or constitutional restraints.

An examination of the *Woolworth* litigation does not reveal any "per se" bar to state taxation of such hypothetical or deemed income. In the *Woolworth* litigation, the Department contended that F.W. Woolworth's Section 78 gross-up income was income for New Mexico apportionment purposes because it was included in the definition of federal taxable income. The court of appeals ruled that the gross-up was not, in fact, actual dividend income to the taxpayer and, therefore, it cannot be classified as business income subject to apportionment in New Mexico. *F.W. Woolworth Co. v. Bureau of Revenue of New Mexico,* 95 N.M. 542, 544, 624 P.2d 51 (Ct. App. 1979). On appeal, the New Mexico Supreme Court reversed the court of appeals, stating that the issue was not whether or not the income was business income. Rather,

the court held that the issue turned on the consideration of the state taxing scheme, which bases New Mexico taxable income on federal income. It ruled that the New Mexico statutory scheme was constitutional, unambiguous and not subject to statutory construction or judicial legislation by the lower court. *Taxation and Revenue Department v. F.W. Woolworth Co.*, 95 N.M. 519 at 521-524, 624 P.2d 28 (1981). Although the United States Supreme Court reversed the New Mexico Supreme Court in *F.W. Woolworth Co. v. Bureau of Revenue*, 485 U.S. 354 (1982), the New Mexico Supreme Court's decision was reversed on grounds other than those surrounding the Section 78 gross-up issue. The Supreme Court ruled that it did not "need . . . [to] be detained" concerning the Section 78 gross-up issue because it had already decided that New Mexico could not tax any dividends, whether they were real or deemed dividends, from F.W. Woolworth's subsidiaries because New Mexico had failed to prove that the requisite unitariness existed between Woolworth and its subsidiaries. Thus, no constitutional basis existed for New Mexico to claim any share of any sort of dividend income from F.W. Woolworth's nonunitary subsidiaries. The two state courts which have examined and applied this aspect of *Woolworth* concur with this interpretation of the *Woolworth* litigation with respect to Section 78 foreign dividend gross-up. *See, NCR Corporation v. Comptroller of the Treasury*, 544 A.2d 764, 768-769 (MD 1988), *International Minerals and Chemical Corp. v. Heitkamp*, 417 N.W.2d 791, 795-796 (ND 1987). Thus, the hypothetical nature of the Subpart F income does not preclude New Mexico from including this income in NCR Corporation's total income subject to apportionment in New Mexico. As long as it is treated as income for federal purposes, a state may include it in income for state purposes as well. *NCR v. Comptroller, supra, International Minerals, supra. See also, Dow Chemical Company v. Director of Revenue*, 787 S.W.2d 276, 284-286 (MO 1990) (*en banc*).

E. *Conclusion.*

For all of the foregoing reasons, IT IS DECIDED AND ORDERED that NCR's protest insofar as it involves a protest to the inclusion of a portion of its Subpart F income which was previously taxed in New Mexico is hereby granted. All other portions of NCR's protest are hereby denied.

Done this 18th day of March, 1991, in Santa Fe, New Mexico.

/s/ Gerald B. Richardson
GERALD B. RICHARDSON
Taxation and Revenue Department

/s/ Dick Minzner
DICK MINZNER
Secretary
Taxation and Revenue Department

APPENDIX C

IN THE SUPREME COURT
OF THE STATE OF NEW MEXICO

July 8, 1993

No. 21,302

NCR CORPORATION,
Petitioner,

vs.

TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO,
Respondent.

This matter coming on for consideration by the Court upon petition for writ of certiorari, and the Court having considered the petition being sufficiently advised;

NOW, THEREFORE, IT IS ORDERED that petition for writ of certiorari hereby IS DENIED.

IT IS FURTHER ORDERED that the record in cause numbered 13,035 hereby is returned to the New Mexico Court of Appeals.

APPENDIX D

NEW MEXICO STATUTES INVOLVED*

7-2A-1. Short title.

Chapter 7, Article 2A NMSA 1978 may be cited as the "Corporate Income and Franchise Tax Act".

7-2A-2. Definitions.

For the purpose of the Corporate Income and Franchise Tax Act [this article] and unless the context requires otherwise:

* * * *

C. "base income" means that part of the taxpayer's income defined as taxable income and upon which the federal income tax is calculated in the Internal Revenue Code for income tax purposes plus, for taxable years beginning on or after January 1, 1991, the amount of the net operating loss deduction allowed by Section 172(a) of the Internal Revenue Code, as that section may be amended or renumbered, and claimed by the taxpayer for that year; "base income" also includes interest received on a state or local bond;

* * * *

I. "net income" means base income adjusted to exclude:

(1) amounts that have been taxed as income under the Banking and Financial Corporations Tax Act;

(2) income from obligations of the United States less expenses incurred to earn that income;

(3) other amounts that the state is prohibited from taxing because of the laws or constitution of this state or the United States;

---

* The statutes in effect for the years at issue (1981-87), which were amended over the years in minor respects having no bearing on the controversy before this Court, are substantially similar to the current statutes, reproduced herein.

(4) for taxable years that began prior to January 1, 1991, an amount equal to the sum of:

(a) net operating loss carryback deductions to that year from taxable years beginning prior to January 1, 1991 claimed and allowed, as provided by the Internal Revenue Code; and

(b) net operating loss carryover deductions to that year claimed and allowed; and

(5) for taxable years beginning on or after January 1, 1991, . . .

7-2A-3. Imposition and levy of taxes.

A. A tax to be known as the "corporate income tax" is imposed at the rate specified in the Corporate Income and Franchise Tax Act [this article] upon the net income of every domestic corporation and upon the net income of every foreign corporation employed or engaged in the transaction of business in, into or from this state or deriving any income from any property or employment within this state.

B. A tax to be known as the "corporate franchise tax" is imposed in the amount specified in the Corporate Income and Franchise Tax Act upon every domestic corporation and upon every foreign corporation employed or engaged in the transaction of business in, into or from this state or deriving any income from any property or employment within this state and upon every domestic or foreign corporation, whether engaged in active business or not, but having or exercising its corporate franchise in this state.

7-2A-4. Consolidated returns.

A. Any corporation that is subject to taxation under the Corporate Income and Franchise Tax Act [this article] and that reports to the internal revenue service for federal income tax purposes its net income consolidated

with the net income of one or more other corporations may elect to report to New Mexico on the same basis.

B. Once a corporation has been included in a consolidated return to New Mexico, the corporation shall not elect to file a New Mexico return under any other method without prior permission of the secretary, unless the change in reporting method is required or allowed under the Internal Revenue Code. Furthermore, such a corporation shall not elect nor shall the secretary grant it permission to separately account for income in New Mexico pursuant to Paragraph (4) of Subsection A of Section 7-2A-8 NMSA 1978.

7-4-1. Short title.

Chapter 7, Article 4 NMSA 1978 may be cited as the "Uniform Division of Income for Tax Purposes Act".

7-4-10. Apportionment of business income.

All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

7-4-11. Property factor for apportionment of business income.

The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

7-4-14. Payroll factor for apportionment of business income.

The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period

by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the tax period.

7-4-16. Sales factor for apportionment of business income.

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

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No. 93-541

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

NCR CORPORATION,
Petitioner,

v.

TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO,
Respondent.

On Petition for Writ of Certiorari to the Court of Appeals of New Mexico

BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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---

BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above-captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of the Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a nonprofit association that was organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST, which was separately incorporated on January 1, 1992, has a membership of more than 400 major multistate corporations, engaged in interstate and international business. COST's objective is to preserve

and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

Many of COST's member companies are engaged in business in the State of New Mexico, and most if not all are engaged in business in at least one state which employs the New Mexico method of taxing foreign source income of domestic corporations. That is, the states include foreign-source income in the domestic parent's apportionable income without inclusion in the parent's apportionment factors of any amounts representing the income-producing factors of the foreign subsidiary-payor. At the same time, these COST member companies are subject to a direct, unapportioned tax on their foreign-source income by the foreign jurisdictions in which the income is earned. Therefore, COST has an interest in the instant case.

SUMMARY OF ARGUMENT

In previous cases, this Court has set out some clear-cut general rules by which an apportionment formula should be judged. The case of *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), adopted an external consistency rule that was first contemplated in Justice Stevens' discussion of factor representation in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980) (Stevens, J., dissenting). Factor representation provides that if value is included in an apportionable tax base, the quantities that generated such value must be included in the apportionment factors. Where, as in this case, the payroll, property and sales included in the factors do *not* correspond with the income subject to formulary apportionment, the formula used cannot be sustained under the authority of *Container Corp.* The case of *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), established the rules by which to determine the constitutional sufficiency of a formula used to apportion income generated by foreign commerce. It set out that where, as in this case, there is inevitable international

multiple taxation of such income, there is a violation of the Foreign Commerce Clause.

The state cannot take refuge in the axiom that, even though distortions are produced by a facially arbitrary formula, it did not miss by much and so is tolerably inaccurate. However useful the test of distortion may be in comparing one apportionment formula to another (*e.g.*, the one-factor versus three-factor formula), it is of no use where the formula is agreed upon but where the principles of that formula have been abandoned. Here, the three-factor formula is agreed upon, but the state has abandoned the fundamental principle of that formula, *i.e.*, that payroll, property and sales that generate income should be used to apportion that income. The state's clear failure to follow the principles of the formula it has adopted should not be condoned, where the error is obvious (the denial of meaningful factor representation) and the corrective measure is equally obvious (factor representation).

While some states use the tools provided by this Court to determine the constitutional sufficiency of an apportionment scheme, others have been unwilling to do so. This Court should ensure that when states exercise the broad discretion that they are accorded to choose an apportionment formula, they do so in a principled manner.

ARGUMENT

I. THE PRESENT CASE IS DISTINGUISHABLE FROM *CONTAINER CORP.* AND CONTROLLED BY *JAPAN LINE.*

Three cases decided by this Court within the last 15 years set forth the principles that guide analysis of the issues in this case. In *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 441 n.15 (1980), this Court acknowledged the issue whether factor representation is required either (i) as an established element of all apportionment schemes, or (ii) as a remedial measure where a particular apportionment scheme results in inevitable international multiple taxation. Although the Court declined to resolve the question in *Mobil* on grounds that it was not timely raised, 445 U.S. at 441 n.15 and at 449, Justice Stevens both analyzed and answered this critical question in his dissent, where he stated:

> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added back to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause [the payee's in-state] income to be overstated.

Id. at 461 (Stevens, J., dissenting).

In *Japan Line Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979), this Court established the principle that in the context of foreign commerce, a state tax must satisfy two distinct Foreign Commerce Clause tests in addition to the four universally applicable Commerce Clause tests articulated in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977).[1] The two considerations distinct to

---

[1] In *Complete Auto,* this Court resolved a Commerce Clause challenge to a tax by analyzing whether such tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce,

taxes impacting foreign commerce are: (i) whether, notwithstanding apportionment, the state tax creates a "substantial risk of international multiple taxation," and (ii) whether the state tax will "impair federal uniformity in an area where federal uniformity is essential," by preventing the federal government from " 'speaking with one voice when regulating commercial relations with foreign governments.' " *Japan Line*, 441 U.S. at 451.

Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983), embodied the *Mobil* principle in its statement of the "external consistency" rule. An apportionment formula under both the Due Process and Commerce Clauses must be fair, and one test of fairness is the external consistency test, *i.e.*, "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Container Corp.*, 463 U.S. at 169. The formula at issue in *Container Corp.* was deemed fair because it incorporated factor representation into the apportionment of foreign-source income;[2] but New Mexico's formula is *not* fair, because it does not allow such representation. Further, this Court in *Container Corp.* applied the principle set forth in *Japan Line*, and found that the formula under review did not cause inevitable international multiple taxation.

The Court of Appeals of New Mexico relied on *Container Corp.* in deciding this case, *see* Petition, App. A at 9a. However, the holding of *Container Corp.* is distinguishable from the present case, precisely because the taxpayer therein was allowed to include in the apportion-

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and is fairly related to the services provided by the State." *Complete Auto*, 430 U.S. at 279.

[2] Because California utilized the unitary combination method of apportionment, it included the income-generating factors of each corporation in the unitary group in the denominators of the apportionment formula.

ment formula the payroll, property and sales that generated the foreign income. In this case, NCR has never been allowed factor representation. *See* Petition, pp. 8, 12. Because the formula at issue in *Container Corp.* fulfilled the requirement of factor representation, its holding cannot be extended to support the New Mexico Court of Appeals' decision in this case.

In addition, the refusal to permit NCR to include in its factors the amounts of payroll, property and sales that generated income from which dividends, royalties and interest were paid means that its foreign-source income will suffer inevitable international multiple taxation. The double income tax burden in this case is no less real and no less inevitable than the double property tax burden on the containers under consideration in *Japan Line*. *See* Petition, pp. 12-13 and nn.7 and 8 thereto. This Court's decision in *Japan Line* established the principle that inevitable international multiple taxation is in *every* instance prohibited. Because this standard is not limited by the factual considerations in that case, *Japan Line* is controlling and the distinctions drawn by New Mexico between NCR's case and *Japan Line,* based on the type of tax and taxpayer involved, are invalid. There is no room for equivocation with respect to this standard; once inevitable international multiple taxation is established, the fifth prong of the Foreign Commerce Clause test is violated. *See Japan Line,* 441 U.S. at 446; *Container Corp.,* 463 U.S. at 185-186. This problem could be corrected simply by giving representation in the apportionment formula to the payroll, property and sales that generated the apportionable income.

II. THE "GROSS DISTORTION" TEST, UPON WHICH THE STATE COURT RESTED ITS CONCLUSION THAT FACTOR REPRESENTATION IS NOT CONSTITUTIONALLY MANDATED, CANNOT APPLY WHERE THERE IS AN ABANDONMENT OF THE PRINCIPLES OF THE APPORTIONMENT FORMULA ADOPTED BY THE STATE.

In determining the constitutionality of one apportionment formula as opposed to another, this Court has established very liberal standards. In the case of *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931) (one-factor formula versus separate accounting), this Court held that a formula that operated "so as to reach profits which are in no just sense attributable to transactions within its jurisdiction" (p. 134) violated the fair apportionment requirement of the Due Process and Commerce Clauses. On the other hand, this Court has declined to strike down apportionment formulas that " 'may result in taxation of some income that did not have its source in the taxing State. . . .' " *Container Corp.*, 463 U.S. at 169-170 (three-factor versus separate accounting) (citing *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 272 (1978) (one-factor versus three-factor)). In the context of a challenge to one apportionment formula grounded in a taxpayer's preference for another formula, this Court has declared that the taxpayer must prove either (i) that the challenged formula attributes income to the taxing state that is " 'out of all appropriate proportions to the business transacted . . . in that State,' " or (ii) that it has " 'led to a grossly distorted result.' " *Id.* at 170.

However, the distortion standard has no role in the constitutional analysis where the formula is agreed on but its principles are abandoned. The State of New Mexico seeks to use the form of the three-factor formula, and your *amicus* does not understand NCR to object to that. But New Mexico has ignored or abandoned the principles on which the formula is based. The State chose

an apportionment formula widely used because the three factors in combination "reflect a very large share of the activities by which value is generated," *id.* at 183. It then included value (income) in the tax base to be apportioned, while arbitrarily refusing to recognize the factors that generated that income. This is not a case where the taxpayer seeks to use a different formula. Here the taxpayer seeks adherence to the principles of the formula chosen by the state; so there is no need to resort to some standard of distortion to determine whether correction is required.

III. NEW MEXICO AND OTHER STATES MUST BE COMPELLED TO ACKNOWLEDGE AND TO COMPLY WITH FOREIGN COMMERCE AND DUE PROCESS PRINCIPLES THAT HAVE LONG BEEN SETTLED.

COST's members and other multinational corporations have been subjected to a miscellany of erroneous interpretations of the constitutional precepts that pertain to the question of factor representation. They often must expend tremendous resources in struggles with states, including New Mexico, to define the general spectrum of what is permitted or required in each state's apportionment scheme. This Court has established working principles such as inevitable multiple taxation and internal and external consistency to guide the determination whether an apportionment scheme is unconstitutional in its design and/or operation. In the use of these principles, the states sometimes succeed in enforcing the integrity of an apportionment fomula. *See, e.g., Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991) (factor representation required when income received from foreign subsidiaries is included in taxpayer's apportionable base); *Homart Dev. Co. v. Norberg*, 529 A.2d 115 (R.I. 1987) (required inclusion of partnership's factors in apportionment formula of nondomiciliary corporation that held interest in and received income from the partnership). But

often, states attempt, as New Mexico has in this case, to avoid the use of these rules by resorting to artificial factual distinctions and analytical subterfuge, in a bid to enforce apportionment schemes already demonstrated to be unconstitutional. This Court should enforce the application of its own announced rules to the case at hand.

CONCLUSION

For the reasons set forth above, the Committee on State Taxation respectfully requests that petitioner's petition for writ of certiorari be granted.

Respectfully submitted,

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On Petition for a Writ of Certiorari to the Court of Appeals of New Mexico

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BRIEF OF AMICUS CURIAE TAX EXECUTIVES INSTITUTE, INC. IN SUPPORT OF PETITIONER

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BRIEF OF AMICUS CURIAE TAX EXECUTIVES INSTITUTE, INC. IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* in support of the petitioner.[1] Tax Executives Institute (hereinafter "TEI" or "the Institute") is a voluntary, non-profit association of corporate and other

[1] TEI has requested and received the written consents of the Petitioner and the Respondent to the filing of this brief; those consents have been filed with the Clerk of this Court.

business executives, managers, and administrators who are responsible for the tax affairs of their employers. The Institute was organized in 1944 and has approximately 4,900 members who represent more than 2,400 of the leading corporations in the United States and Canada.

TEI is dedicated to promoting the uniform and equitable enforcement of the tax laws throughout the Nation, to reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers, and to vindicating the Commerce Clause and other constitutional rights of all business taxpayers. The members of the Institute represent a cross-section of the business community in North America and are, almost without exception, engaged in interstate or foreign commerce. The multijurisdictional companies represented by the Institute's membership are significantly affected by the allocation and apportionment of income among the various States. As a result, TEI's members will be directly affected by the Supreme Court's decision whether to grant a writ of certiorari in this case.

The issue presented in this case is whether New Mexico and other States are precluded from taxing foreign-source dividends, interest, and royalties that have already been subject to tax on an unapportioned (*i.e.*, allocated) basis by foreign countries and, if so, on what basis such taxation may occur. The case raises fundamental issues about the rights embodied in the Foreign Commerce Clause of the Constitution and the legitimacy of a State's apportionment scheme under the Interstate Commerce and Due Process Clauses. *Amicus* TEI submits that a writ of certiorari should be issued here to enable the Court to confirm that the Commerce and Due Process Clauses do not permit apportionment without taking into account the apportionment factors of the business generating that income and, further, that the Foreign Commerce Clause

proscribes the taxing of foreign-source income that is already subject to tax on an unapportioned basis by foreign countries.

There can be no doubt that this case raises a recurring issue having a broad effect on U.S. companies operating overseas and receiving dividends, interest, and royalties from overseas affiliates. The amount of dividends alone paid or constructively received by domestic corporations from foreign sources in 1986 totalled over $22 billion.[2] Because TEI members and the companies by whom they are employed will be materially affected by the Court's decision, the Institute has a special interest in the outcome of this case.

SUMMARY OF ARGUMENT

1. Under the Commerce and Due Process Clauses of the Constitution, a State may not tax value outside its borders. Such taxation is proscribed because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 335 (1977), and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

This Court has rightly observed that dividing income among the several States bears some resemblance to "slicing a shadow." *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 192 (1983). A reasonable balance must be struck between the State's legitimate need for revenue and the taxpayer's legitimate right to protection from overreaching taxing authorities. To pass constitutional muster, the apportionment formula must be fair: It must

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[2] Karla M. Daronco, *1986 Corporation Foreign Tax Credit, A Geographic Focus*, 10 STATISTICS OF INCOME BULL. 31, 46 (IRS Pub. No. 1136, Winter 1990-91).

be marked by both internal and external consistency. *Container Corp.*, 463 U.S. at 169.

Here, the issue is whether the apportionment formula used by New Mexico is properly designed to ensure against the proscribed taxation of extraterritorial values. In this case, the State of New Mexico included all of NCR Corporation's dividends, interest, and royalties from its foreign subsidiaries in its apportionable tax base, even though that income was subject to tax on an allocated (or unapportioned) basis in the foreign countries where NCR Corporation does business. Moreover, the State refused to include in the denominator of the three-factor apportionment formula the property, payroll, and sales that produced that income.

Amicus TEI submits that an apportionment formula that fails by design to take into account the factors generating the apportioned income is constitutionally flawed. Thirteen years ago, the Court acknowledged that the factor representation issue could be one of constitutional import, but declined to resolve it on the ground that the issue had not been properly raised by the taxpayer. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 441 n.15 (1980). Justice Stevens, however, found the issue dispositive and would have proscribed "lump[ing] huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base" without taking into account the factors that produced that income. *Id.* at 461 (Stevens, J., dissenting).

Without a doubt, New Mexico's apportionment formula should be struck down as violating *Container Corp.*'s requirement of fairness: It is internally inconsistent in that if it were applied by every jurisdiction it would result in more than 100 percent of NCR Corporation's income being taxed, and it is externally inconsistent in that it does not represent a reasonable sense of how the income

was generated. Only by requiring factor representation can the Court vindicate the constitutional requirement of a "fair" apportionment formula.

2. The constitutional prohibition against state taxation of *foreign* commerce is "broader than the protection afforded to interstate commerce . . . ." *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Finance,* 112 S. Ct. 2365, 2370 (1992). *Amicus* TEI submits that, even if New Mexico's statute does not offend the Interstate Commerce and Due Process Clauses, it must fall under the Foreign Commerce Clause.

To prevent multiple taxation of interstate commerce, a State's apportionment formula must be applied in a manner such that "no instrumentality of commerce is subjected to more than one tax on its full value." *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434, 447 (1979). If a State's taxing scheme "inevitably" leads to multiple taxation, it must be struck down under the Foreign Commerce Clause. *Container Corp.*, 463 U.S. at 188; *Japan Line,* 441 U.S. at 447.

In this case, the State of New Mexico included in the apportionable tax base the dividends, interest, and royalties received by the taxpayer from its foreign subsidiaries —income that was subject to tax in full without apportionment by foreign taxing authorities. If other States were to follow New Mexico's lead, "various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from 'speak[ing] with one voice' in regulating commerce." *Japan Line,* 441 U.S. at 450-51 (quoting *Michelin Tire Corp. v. Wages,* 423 U.S. 276, 285 (1976)).

Amicus TEI submits that the Foreign Commerce Clause does not permit such apportionment of foreign income without taking into account the property, payroll, and sales factors that generated the income. The Court should

grant a writ of certiorari to address the question left open in *Mobil*.

3. A writ of certiorari should also issue in this case because the decision of the New Mexico Court of Appeals conflicts with this Court's 1992 decision in *Kraft General Foods*. In that case, the Court found that the State's preference for domestic commerce (which was evidenced by permitting a deduction for dividends received from domestic, but not foreign subsidiaries) over foreign commerce was inconsistent with the Constitution. The Court therefore invalidated the Iowa statute because it "facially discriminate[d] against foreign commerce and therefore violate[d] the Foreign Commerce Clause . . . ." 112 S. Ct. at 2372.

Like the Iowa statute involved in *Kraft General Foods*, the New Mexico statute here defines "net income" as federal taxable income with certain adjustments for New Mexico tax purposes. Because NCR Corporation filed returns on a federal consolidated basis, transactions between members of the domestic consolidated group (such as dividends, interest, and royalties) were effectively eliminated from NCR Corporation's apportionable base for New Mexico tax purposes. Thus, under the New Mexico statute, NCR Corporation's taxable income did not generally include dividends, interest, and royalties received from domestic subsidiaries, but did include similar intercompany payments received from its foreign subsidiaries. Moreover, the factors that generated that income from the domestic subsidiaries were included in NCR Corporation's apportionable tax base, whereas the factors relating to the foreign subsidiary income were not.

In *Kraft General Foods*, the Court found the dichotomy between the treatment of dividends received from domestic and foreign subsidiaries discriminatory, unjustified, and constitutionally fatal. *Id.* at 2372. *Amicus* TEI sub-

mits that the New Mexico statute is similarly flawed. *See also Boston Stock Exch.*, 429 U.S. at 329, where the Court unequivocally held that the Commerce Clause proscribes the granting of a preference to one form of commerce over another. This Court should grant certiorari to reject this preference.

ARGUMENT

I. NEW MEXICO'S FAILURE TO PROVIDE FACTOR REPRESENTATION VIOLATES THE COMMERCE AND DUE PROCESS CLAUSES

Under the Commerce and Due Process Clauses of the Constitution,[3] a State may not tax value outside its borders. *E.g., Connecticut Gen. Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938). Such taxation is proscribed because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 335 (1977), and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

This Court has rightly observed that dividing income among the several States bears some resemblance to "slicing a shadow." *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 192 (1983).[4] Absolute consistency, even

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[3] U.S. Const. art. I, § 8, cl. 3 (Commerce Clause); U.S. Const. amend. XIV, § 1 (Due Process Clause).

[4] Although the terms "allocation" and "apportionment" are often used interchangeably in respect of the division of income among various jurisdictions, "allocation" properly refers to the "attribution of a particular type of income or receipt or property or the like to a designated State, [and] 'apportionment' refers to the division of the tax base by formula." JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION I: CORPORATE INCOME AND FRANCHISE TAXES ¶ 9.01, at 9-5 n.1 (2d ed. 1993). A typical "three-factor" formula—similar to the one used by the State of New Mexico

among taxing authorities using the same apportionment formula, "may just be too much to ask," *id.*,[5] but there are constitutional limits on a State's use of an apportionment formula, especially in respect of income derived in foreign commerce.[6] In other words, a balance must be struck between the State's unmistaken need for revenue and the taxpayer's legitimate right to protection from overreaching taxing authorities. It is for this Court to ensure that the balance is a reasonable one.[7] If the State

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in this case—compares (i) the taxpayer's property, payroll, and sales (receipts) within the taxing State to (ii) the taxpayer's total property, payroll, and sales. UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT (U.L.A.), §§ 9-15. Some jurisdictions use single-factor, double-factor, or weighted-factor formulae. HELLERSTEIN & HELLERSTEIN, *supra*, at ¶ 9.06.

[5] Although an apportionment formula may be "imperfect," it is nevertheless an "acceptable method of measuring the in-state earnings of an integrated business." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 452 (1980) (Stevens, J., dissenting). One means of taxing in-state income is the use of the unitary business principle which calculates the local tax base by first defining the scope of the unitary business of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of the unitary business between the taxing jurisdiction and the rest of the world based on a formula taking into account objective measures of the corporation's activities within and without the jurisdiction. *Container Corp.*, 463 U.S. at 165. The apportionment system used by the State of New Mexico is based on the unitary business principle. Appendix B to NCR Corporation's Petition for a Writ of Certiorari to the Court of Appeals of New Mexico (App.), at 41a-42a (No. 93-541).

[6] In evaluating challenges to state taxing schemes, the Court examines the practical effect of a challenged tax to determine whether it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

[7] *See Boston Stock Exch.*, 429 U.S. at 329 (the Court has a duty "to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers").

has not "given anything for which it can ask return" in respect of the person, property, or transaction it seeks to tax, *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940), the Commerce and Due Process Clauses operate as a constitutional brake upon the State's raw power to tax.

To pass constitutional muster under the Commerce and Due Process Clauses, the apportionment formula must, first and foremost, be fair. *Container Corp.*, 463 U.S. at 169. There must be internal consistency: "[T]he formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed." *Id.* There must also be external consistency: "[T]he factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Id.*

Here, the issue is whether the apportionment formula used by New Mexico is properly designed to ensure against the proscribed taxation of extraterritorial values. In this case, the State of New Mexico included all of NCR Corporation's dividends, interest, and royalties from its foreign subsidiaries in its apportionable tax base, even though the income was subject to tax on an allocated (or unapportioned) basis in the foreign countries where NCR Corporation does business. (App. B at 25a-26a.) Moreover, the State refused to include in the denominator of the three-factor apportionment formula the property, payroll, and sales that produced that income.[8] Thus, New

[8] The parties stipulated that the gross amount of the payments received by NCR Corporation in the form of dividends, royalties, and interest was gross income earned directly by NCR Corporation. Consequently, NCR Corporation was subject to the taxing jurisdiction of each of the host countries in respect of this income. The tax on the income was generally paid through a withholding mechanism that required the subsidiary to withhold tax on the payment at a flat rate and pay over the amount of NCR Corporation's tax liability to the foreign country. The withholding rates ranged from 0 percent to 40 percent of the gross amount. (App. B at 25a-26a.)

Mexico's taxing scheme did not provide for "factor representation" in respect of NCR Corporation's foreign income.

Amicus TEI submits that an apportionment formula that fails by design to take into account the factors that generated the apportioned income is constitutionally flawed because there can never be a "rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil*, 445 U.S. at 436-37. The failure to provide factor representation is "inherently arbitrary," *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920), and cannot help but produce a result that reflects neither "a reasonable sense of how [the] income [was] generated" (as required by *Container Corp.*, 463 U.S. at 169) nor "the relative contribution of the activities in the various States [specifically, New Mexico] to the production of total unitary income" (*Butler Bros. v. McColgan*, 315 U.S. 501, 509 (1942)).[9] This Court's prior holdings teach this conclusion and common sense confirms it.

In *Mobil*, the Court acknowledged that the factor representation issue could be one of constitutional import, but declined to resolve it on the ground that the issue had not been properly raised by the taxpayer. 445 U.S. at 434, 441 n.15, 449.[10] Justice Stevens, however, found

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[9] The skewed manner in which the State of New Mexico applies its apportionment formula is readily apparent when one considers that the State seeks to include the foreign-source income in the calculation, but "refuses to go any further in recognizing the unitary principle" by including the apportionment factors. *See American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue*, 422 N.W.2d 629, 632 (Wis. App. 1988).

[10] The lower court's statement in this case (App. A at 16a) notwithstanding, the Court did *not* reject the concept of factor representation in *Mobil*. Rather, the Court reserved the question, stating that "we need not, and do not, decide whether combined apportionment of this type [inclusion of the Mobil subsidiaries' and affiliates' sales, payroll, and property in the apportionment formula]

the issue dispositive and would have proscribed "lump-[ing] huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base" without taking into account the factors that produced that income. 445 U.S. at 461 (Stevens, J., dissenting). Justice Stevens explained:

> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will *inevitably* cause Mobil's Vermont income to be overstated.

Id. (emphasis added). *See also* JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION I: CORPORATE INCOME AND FRANCHISE TAXES ¶ 9.13[3][b], at 9-87 (2d ed. 1993) (if the unitary concept is the foundation for the inclusion of dividends in the apportionable base, that concept "should carry through to all aspects of the tax computation," including factor representation).

In a 1991 case, the Maine Supreme Court forthrightly addressed this issue and held that the lack of factor representation was constitutionally fatal to a taxing scheme:

> [Without factor representation,] [t]he ineluctable result is that more of the business activity of the unitary business is attributed to [the State] than is the actual case. Thus, the income taxable by [the State] under the Assessor's formula does not truly reflect [the corporation's] connection with [the State] and

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is constitutionally required." 445 U.S. at 441 n.15. *See also id.* at 449 ("[b]ecause the issue has not been presented, we need not, and do not, decide what the constitutent elements of a fair apportionment formula applicable to such income would be"). The reservation of this issue was specifically recognized by the Court in *Container Corp.*, 463 U.S. at 168 n.5, and by the hearing officer in this case, App. B at 54a.

> fails to meet the test of fairness required by the due process clause.

Tambrands, Inc. v. State Tax Assessor, 595 A.2d 1039, 1044 (Me. 1991).[11]

The compelling nature of Justice Stevens's reasoning is illustrated by the following example. Assume that the taxpayer's activities within the United States are conducted exclusively in New Mexico—that is to say, 100 percent of its domestic property, payroll, and sales are in that State. Assume further that the taxpayer owns a foreign subsidiary whose property, payroll, and sales are equal to the taxpayer's U.S. (New Mexico) factors. Finally, assume that the taxpayer makes $100 from its New Mexico operations and receives a $100 dividend from its foreign subsidiary (which dividend is subject to a withholding tax by the foreign country). Under New Mexico's taxing scheme, all of the taxpayer's income would be apportioned to New Mexico. Thus, 100 percent of the foreign

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[11] In addition to Maine, other States have concluded that the failure to provide factor representation in applying the apportionment rules to unitary businesses contravenes the Due Process and Commerce Clauses. *See, e.g., American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue*, 422 N.W.2d at 636 (involving dividends from unitary subsidiaries); *Homart Dev. Co. v. Norberg*, 529 A.2d 115, 121 (R.I. 1987) (involving distributive share from partnership). *See also NCR Corp. v. South Carolina Tax Comm'n*, 402 S.E.2d 666, 674 (S.C. 1991) (case remanded to determine appropriate factors to include with respect to interest and royalties from unitary subsidiaries); *NCR Corp. v. Comptroller of Treasury*, 544 A.2d 764, 781 (Md. 1988) (same with respect to dividends from unitary subsidiaries). *See* E. George Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Group*, 25 TAX L. REV. 171, 205 (1970) ("Obviously, if the foreign source income is included in the base for apportionment, foreign property, payrolls, and sales must be included in the apportionment fractions. This was recognized in *Bass* [, *Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924)] . . ."). *But see NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86, 94 (Minn.), *cert. denied*, 493 U.S. 848 (1989) (excluding foreign subsidiaries' factors does not result in constitutional violation).

dividend would be apportioned to, and taxed by, the State, even though that dividend was taxed on an allocated, or unapportioned, basis in the foreign country and even though the foreign factors generating that dividend equalled the taxpayer's New Mexico factors. In other words, the taxpayer would be subject to tax on $300—$100 by the foreign jurisdiction and $200 by New Mexico—even though it earned only $200.

Without a doubt, New Mexico's apportionment formula should be struck down as violating *Container Corp.*'s requirement of fairness: It is internally inconsistent in that if it were applied by every jurisdiction it would result in more than 100 percent of NCR Corporation's income being taxed, and it is externally inconsistent in that it does not represent a reasonable sense of how the income was generated. *See Container Corp.*, 463 U.S. at 169-70. The Court should grant a writ of certiorari in this case to clarify that where a State seeks to apportion nondomiciliary income, the State's apportionment formula must include an appropriate portion of the taxpayer's payroll, property, and sales. Only by requiring factor representation can the Court vindicate the constitutional requirement of a "fair" apportionment formula. *Container Corp.*, 463 U.S. at 169.

II. NEW MEXICO'S TAXING SCHEME INEVITABLY LEADS TO DOUBLE TAXATION AND THEREFORE VIOLATES THE FOREIGN COMMERCE CLAUSE

The constitutional prohibition against state taxation of *foreign* commerce is "broader than the protection afforded to interstate commerce . . . ." *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Finance*, 112 S. Ct. 2365, 2370 (1992) (citing *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 445-46 (1979)). Thus, a state tax cannot survive scrutiny under the Foreign Commerce Clause if the tax creates a substantial risk of international multiple taxation, or prevents "the Federal Government

from 'speak[ing] with one voice when regulating commercial relations with foreign governments.'" *Japan Line*, 441 U.S. at 451 (quoting *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 285 (1976)). The elevated protection for foreign commerce—which extends not only to foreign taxpayers but to U.S. taxpayers engaged in such commerce—owes itself to the realization that a State's interference with "foreign commerce may create problems, such as the potential for international retaliation, that concern the Nation as a whole." *Kraft Gen. Foods*, 112 S. Ct. at 2370. *Amicus* TEI submits that, even if New Mexico's statute did not offend the Commerce and Due Process Clauses, it should fall under the Foreign Commerce Clause.

To prevent multiple taxation of interstate commerce, a State's apportionment formula must be applied in a manner such that "no instrumentality of commerce is subjected to more than one tax on its full value." *Japan Line*, 441 U.S. at 447. Although in the domestic context the Court may "enforce full apportionment by all potential taxing bodies," it cannot ensure full aportionment when one of the taxing authorities is a foreign nation. *Id.* In such situations, if a State's taxing scheme "inevitably" leads to multiple taxation, it must be struck down under the Foreign Commerce Clause. *Container Corp.*, 463 U.S. at 188; *Japan Line*, 441 U.S. at 447.

In this case, the State of New Mexico included in the apportionable tax base the dividends, interest, and royalties received by the taxpayer from its foreign subsidiaries —income that was subject to tax in full without apportionment by foreign taxing authorities. (App. B at 31a-33a.) Thus, one taxing jurisdiction has claimed the right to tax a given value in full, and another taxing jurisdiction has claimed the right to tax the same entity in part—"a combination resulting necessarily in double taxation." *Itel Containers Internat'l Corp. v. Huddleston*, 113 S. Ct. 1095, 1103 (1993) (quoting *Container Corp.*, 463 U.S.

at 188);[12] *accord Mobil*, 445 U.S. at 444-45 ("[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate . . ."). If other States were to follow New Mexico's lead (and, regrettably, many have adopted similarly flawed schemes), "various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from 'speak[ing] with one voice' in regulating commerce." *Japan Line*, 441 U.S. at 450-51 (quoting *Michelin Tire Corp.*, 423 U.S. at 285).[13]

Amicus TEI submits that the Foreign Commerce Clause does not permit such apportionment of foreign income without taking into account the property, payroll, and sales factors that generated the income. Requiring the

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[12] In *Itel*, the Court stated that the Foreign Commerce Clause cannot be interpreted to demand that a state refrain from taxing any business transaction that is *potentially* subject to taxation by a foreign sovereign. 113 S. Ct. at 1104. Here, in contrast, the lower court found multiple taxation to be real. (App. A at 11a.) Moreover, the tax upheld in *Itel* fell on a discrete transaction occurring within Tennessee and the State there provided a credit for any tax properly paid in another jurisdiction, foreign or domestic, on the same transaction. 113 S. Ct. at 1104. In this case, New Mexico included the taxpayer's entire foreign dividend, interest, and royalty income in the apportionment formula without providing any sort of credit.

[13] The hearing officer in this case averred that multiple taxation was not inevitable because not every foreign country in which the taxpayer operated chose to tax its dividends, interest, and royalties. (App. B at 49a-50a.) Such a facile analysis, however, misapprehends the Court's foreign commerce jurisprudence: there is no requirement that an apportionment scheme result in tax *in every instance*, only that multiple taxation—whether in one or more jurisdictions—be unavoidable. *Japan Line*, 441 U.S. at 452. As the Court found in *Japan Line*, "[e]ven a slight overlapping of tax—a problem that might be deemed *de minimis* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Id.* at 456 (footnote omitted). Even the New Mexico Court of Appeals conceded that multiple taxation was "real." (App. A at 11a.)

States to provide factor representation is necessary to prevent the inevitable multiple taxation that would otherwise ensue.[14] In *Mobil*, the Court left open the question whether the Foreign Commerce Clause required factor representation because the issue had not been properly raised. 445 U.S. at 449. The Court should grant a writ of certiorari to redress this constitutional violation.

III. THE DECISION OF THE COURT BELOW CONFLICTS WITH THIS COURT'S DECISION IN *KRAFT GENERAL FOODS*

A writ of certiorari should issue in this case because the decision of the New Mexico Court of Appeals conflicts with this Court's 1992 decision in *Kraft General Foods*. In that case, this Court scrutinized an Iowa statute that used the federal definition of "net income" with certain adjustments. For federal tax purposes, corporations are generally allowed a deduction for dividends received from domestic subsidiaries. I.R.C. § 243 (1986). In following the federal scheme, Iowa permitted a deduction for dividends from domestic subsidiaries, but included dividends from foreign subsidiaries in taxable income. The Court found that the "State's preference for domestic commerce over foreign commerce [was] inconsistent with the Commerce Clause . . . ." 112 S. Ct. at 2370. The Court therefore held the Iowa statute unconstitutional because it "facially discriminate[d] against foreign commerce and therefore violate[d] the Foreign Commerce Clause." *Id.* at 2372.[15]

Like the Iowa statute involved in *Kraft General Foods*, the New Mexico statute here defines "net income" as fed-

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[14] The failure to provide factor representation thus distinguishes this case from *Container Corp.*, where the sustained California taxing scheme included not only the combined income, but also the combined factors of the taxpayer and its subsidiaries. 463 U.S. at 174-75.

[15] The Court also held that the flow of value, including dividends, between Kraft and its foreign subsidiaries constituted "foreign commerce." 112 S. Ct. at 2369.

eral taxable income with certain adjustments for New Mexico tax purposes. N.M. Stat. Ann. §§ 7-2A-2(C) and (I) (Michie 1978) (1993 Repl.). (App. D at 71a.) Because NCR Corporation filed returns on a federal consolidated basis (App. B at 21a), transactions between members of the domestic consolidated group (such as dividends, interest, and royalties) were effectively eliminated from NCR Corporation's apportionable base for New Mexico tax purposes.[16] Thus, under the New Mexico statute, NCR Corporation's taxable income did not generally include dividends, interest, and royalties received from domestic subsidiaries, but did include similar intercompany payments received from its foreign subsidiaries.[17] (App. B at 26a-27a.) Moreover, the factors that generated that income from the domestic subsidiaries were included in NCR Corporation's apportionable tax base, whereas the factors relating to the income from the foreign subsidiaries were not.

In *Kraft General Foods*, the Court found the dichotomy between the treatment of dividends received from domestic and foreign subsidiaries discriminatory, unjustified,

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[16] Under the applicable Treasury Regulations, dividends distributed from one member of a consolidated group to another member are eliminated in calculating taxable income. Treas. Reg. § 1.1502-14(a)(1) (1993). With respect to interest and royalties, there is essentially a "wash" between the two members of a consolidated group. Thus, if Member A makes an interest payment on an indebtedness to Member B, Member A receives a deduction for the interest and Member B is required to take the interest payment into income. Treas. Reg. § 1.1502-13(b)(1) (1993) (setting forth the rules for treatment of intercompany transactions). Because foreign subsidiaries are not generally part of the consolidated group, no member of the consolidated group may take a deduction for federal tax purposes for income payments received from foreign subsidiaries opearting abroad.

[17] The dividends, interest, and royalties NCR Corporation received from its foreign subsidiaries were also included in its federal taxable income, but the federal taxing scheme allows a credit for taxes paid to foreign taxing authorities. I.R.C. § 901 (1986); *see* App. B at 23a. New Mexico does not allow such a credit for foreign taxes.

and constitutionally fatal. *Id.* at 2372. The New Mexico statute is similarly flawed.

With respect to dividends, *Kraft General Foods* unwaveringly teaches that a statute that differentiates between the deduction for domestic dividends and the deduction for foreign dividends facially discriminates against foreign commerce. In addition, the New Mexico statute treats interest and royalties received from foreign subsidiaries differently from the payments received from domestic subsidiaries. Finally, New Mexico failed to take into account the factors generating the income for the foreign subsidiaries, while the factors for domestic subsidiaries were included in the formula. New Mexico thus "imposes a burden on foreign subsidiaries that it does not impose on domestic subsidiaries." *Kraft Gen. Foods,* 112 S. Ct. at 2371. *See also Boston Stock Exch.,* 429 U.S. at 329, where the Court unequivocally held that the Commerce Clause proscribes the granting of a preference to one form of commerce over another. This discrimination between foreign and domestic entities is "wholly inconsistent with the free trade purpose of the Commerce Clause." *See id.* at 336. This Court should grant certiorari to reject this preference.

CONCLUSION

For the foregoing reasons, the Court should grant a writ of certiorari in this case.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

NCR CORPORATION,

Petitioner,

v.

TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO,

Respondent.

On Petition for Writ of Certiorari to the Court of Appeals of New Mexico

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BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether a state may, consistent with the Foreign Commerce Clause, include in income subject to apportionment for income tax purposes dividends, interest and royalties earned from unitary foreign subsidiaries by U.S. corporations doing business in the state?

2. Whether the Due Process or Commerce Clauses require states, when applying the three-factor apportionment formula to a U.S. corporate taxpayer, to include in the apportionment formula all the property, payroll and sales factors of the taxpayer's foreign subsidiaries where: (a) the state does not tax the incomes of the foreign subsidiaries; (b) the average income earned by the taxpayer from these subsidiaries constitutes less than 10% of the subsidiaries' average gross income; (c) the income is already included in the denominator of the taxpayer's sales factor; and (d) the taxing state's apportionment formula is already externally and internally consistent?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

NCR CORPORATION,

Petitioner,

v.

TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO,

Respondent.

On Petition for Writ of Certiorari to the Court of Appeals of New Mexico

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BRIEF IN OPPOSITION

The Taxation and Revenue Department of the state of New Mexico respectfully requests that this Court deny the Petition for a Writ of Certiorari filed by the NCR Corporation.

STATEMENT OF THE CASE

Appellant NCR Corporation, a United States corporation, challenges New Mexico's authority to include in NCR's apportionable income amounts NCR received as royalties from patents, interest on loans, and dividends from its foreign

subsidiaries.[1] New Mexico is not attempting to tax any of the income of the foreign subsidiaries. Instead, it is imposing its tax on what both parties agree is NCR's "business income" as defined under New Mexico law because it "arises from transactions and activities in the regular course of NCR's trade or business" operations. Findings of Fact, ¶ 8 (App. B at 23a). *See* Section 7-4-2(A) NMSA 1978 defining "business income." Both sides also agree that NCR's income that New Mexico seeks to tax comes from subsidiaries that are in all respects unitary with NCR. Findings of Fact, ¶¶ 5-8 (App. B at 21a-23a). Finally, there is no dispute that this dividend, royalty and interest income was NCR's income and was included in NCR's federal taxable income each year at issue here. Findings of Fact, ¶ 10 (App. B at 23a). Nonetheless, NCR claims that New Mexico cannot tax an apportioned share of this income because some foreign countries have imposed or may claim a right to impose an unapportioned tax on this income.

New Mexico's method of taxing corporate income works in fundamentally the same manner as that of the majority of states. *See* Court of Appeals decision below, 856 P.2d at 985, Appendix A to the Petition for a Writ of Certiorari at 5a. The state taxes U.S. corporations doing business in New Mexico by apportioning to New Mexico a very small share (reflecting the proportion of business done in New Mexico) of their total income reported to the federal government and then applying New Mexico's corporate tax rate to the resulting taxable

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[1]See stipulated Findings of Fact ¶¶ 1-14, adopted by the Hearing Officer below and set forth in Appendix B to the Petition for A Writ of Certiorari at pp. 20a-25a, for a description of NCR's worldwide integrated business. Hereinafter, all references to the Findings of Fact will be accompanied by a page reference to Appendix B.

income.[2] For the years at issue in this case, New Mexico imposed tax on between 0.3307% and 0.2207% of NCR's annual federal taxable income. *See* New Mexico's apportionment factors set forth in Findings of Fact ¶ 36 (App. B at 36a).

Fundamentally, NCR's various arguments as to why New Mexico cannot tax its foreign source income are merely stale wine in new bottles. Over a decade ago, Mobil Oil Corporation and Container Corporation each made the same arguments and each failed to convince this Court. *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425 (1980), and *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

Now NCR Corporation tries to distinguish its situation from those presented to the Court by the Mobil Oil and Container corporations. However, the distinctions it draws do not amount to a constitutional difference. Both the Court of Appeals and the Hearing Officer below recognized this and rejected NCR's

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[2]New Mexico statutes require calculation of corporate income tax by the following method:

1. start with federal taxable income,
2. deduct foreign dividend gross-up, income from United States obligations, and "non-business" income allocated to other states,
3. apportion this New Mexico apportionable income in accordance with the three factor formula specified by the Uniform Division of Income for Tax Purposes Act (UDITPA), and
4. apply the tax rate to this New Mexico taxable income to arrive at the tax due.

See Uniform Division of Income for Taxation Purposes Act (UDITPA) Sections 7-2A-2(C), 7-2A-2(J)(2), 7-2A-8, 7-4-10 through 7-4-18, 7-2A-3 NMSA 1978.

arguments in well-reasoned decisions. Moreover, over the last few years NCR has tried identical arguments in three other state appellate courts and lost. *NCR Corporation v. Commissioner of Revenue*, 438 N.W.2d 86 (MN 1989), *cert. denied*, 493 U.S. 848 (1989) (hereinafter "*NCR (Minnesota)*"); *NCR Corporation v. South Carolina Tax Commission*, 402 S.E.2d 666 (SC 1991) (hereinafter "*NCR (South Carolina)*"); and *NCR Corporation v. Comptroller of the Treasury*, 544 A.2d 764 (MD 1988) (hereinafter "*NCR (Maryland)*").

REASONS FOR DENYING THE WRIT

The Petition for a Writ of Certiorari should be denied for the following reasons. As to NCR's Foreign Commerce Clause claim, the decision by the New Mexico Court of Appeals correctly relies on this Court's decision in *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983). *See also Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Finance*, ___ U.S. ___, 112 S. Ct. 2365 (1992). This case does not raise significant issues which were not addressed in *Container* and *Kraft* (112 S. Ct. at 2371, n. 23). In addition, this Court previously denied NCR's Petition for a Writ of Certiorari raising virtually identical issues in *NCR (Minnesota)*, 493 U.S. 848 (1989). Moreover, the state courts which have considered the Foreign Commerce Clause issues raised here by NCR have unanimously ruled that state taxing schemes like New Mexico's are constitutional under *Container*. *See NCR (Minnesota)*, 438 N.W.2d at 93-95; *NCR (South Carolina)*, 402 S.E.2d at 669-672; *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039, 1042 (Me. 1991).

New Mexico is taxing only its apportioned share (between one-third and one-fifth **of one percent**) of the income of a United States corporation which: 1) has substantial contacts with New Mexico, 2) engages in its unitary business in New

Mexico, and 3) enjoys the benefits of the civilized business environment New Mexico provides. The income of the foreign subsidiaries, themselves, is not being taxed by New Mexico and is not involved here at all. NCR's argument—that a foreign country's decision to tax a U.S. corporation on a portion of its earnings constitutionally ousts states' taxing authority—cedes far too much of states' sovereignty to other countries in the name of protecting United States corporations from taxation.

If Congress wanted to put an end to state taxation of domestic corporations' income, including income from foreign sources, it could stop it. However, Congress has not seen fit to do so. "Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income." *Mobil Oil*, 445 U.S. at 448-449 (lengthy citation to congressional debates omitted). Neither federal statutes nor treaties prohibit imposition of a state's tax on this income. Here, as in *Container*, there are no "specific indications" of congressional intent to pre-empt state taxation of foreign dividends, royalties or interest received by United States parent corporations. 463 U.S. at 196-197. In both *Mobil Oil* and *Container* this Court ascribed the proper meaning to congressional inaction and allowed this type of taxation by the states to stand.

Finally, there are strong administrative concerns weighing against the adoption of NCR's proposal that any income arguably from a foreign source and arguably subject to the potential of a foreign tax cannot be taxed at all by the states. In *Mobil Oil*, where only dividends were at issue, the Court noted:

> nothing about the logic of Mobil's position is limited to dividend income. The same contention could be advanced about any income arguably earned from foreign commerce. If appellant's argument were

> accepted, state taxing commissions would face substantial difficulties in attempting to determine what income does or does not have a foreign source.

445 U.S. at 447. In this case, NCR seeks to extend that argument to interest and royalty payments, but NCR's argument could extend as well to income it receives from any sale of services or property in international commerce. This argument was rejected by the Court in *Container* and *Mobil Oil*.

As to NCR's Due Process claim that it is entitled to include the entire property, payroll and sales of its foreign subsidiaries in its apportionment factors, the Court of Appeals below did not break new constitutional ground, but properly applied long-settled constitutional principles of state taxation set forth in *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931), and *Mobil Oil*, in upholding New Mexico's apportionment method. Indeed, New Mexico's method of apportioning NCR's income is the "benchmark" method endorsed by the Court in *Container*, 463 U.S. at 170, and it is both externally and internally consistent as applied.

In addition, the determination whether factor representation is required always calls for a case by case, fact-specific analysis which will be different for each taxpayer. Here, the determination below was dependant on the specific facts of this case which demonstrated neither gross distortion nor internal inconsistency. Moreover, the only factor relief requested below by NCR was the inclusion in its apportionment factors of the **entire** property, payroll and sales of these foreign subsidiaries, even though only a small portion of those subsidiaries' income was paid to NCR and included in the apportioned base. What-is-more, New Mexico has already provided NCR factor representation by including all this foreign source income in the denominator of the sales factor, thereby reducing significantly

NCR's New Mexico apportionment factor. Thus, any ruling here is likely to turn on these specific facts and not necessarily be more broadly applicable.

Finally, to the extent some state courts have recognized that factor adjustment may be appropriate in some circumstances, few courts have determined the type and extent of adjustment necessary and wide latitude has been given the states.[3] Accordingly, the Court should await further development of factor representation models and legal principles by the state courts before determining whether to accept this issue for review.

I. THE COURT OF APPEALS CORRECTLY RELIED ON THIS COURT'S FOREIGN COMMERCE CLAUSE JURISPRUDENCE TO ALLOW STATE TAXATION OF NCR'S UNITARY "FOREIGN SOURCE" INCOME.

NCR's entire argument relies on the application of the Commerce Clause[4] of the United States Constitution to one case: *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). But this reliance is misplaced. The controlling case regarding application of the Foreign Commerce Clause to state corporate income taxation is *Container*, not *Japan Line*. This is because *Japan Line* did not deal at all with corporate income

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[3]See, e.g., *Tambrands, Inc.*, 595 A.2d at 1045; *American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629, 636-637 (Ct. App. 1988).

[4]The Commerce Clause of the United States Constitution provides: "Congress shall have power ... to regulate commerce with foreign nations, and among the several states, and with the Indian tribes." U.S. Const. Art. I, sec. 8, cl. 3.

taxation by the states or with a domestic taxpayer, but with an entirely different and very special situation: state imposition of an ad valorem property tax on cargo containers owned by Japanese companies which were instrumentalities of foreign commerce and which were temporarily located in California ports en route to other destinations. *Container*, by contrast, dealt exactly with state income taxation of an apportioned share of the income received by a U.S. corporation from foreign subsidiaries.

The tax at issue in *Container*, like the tax at issue here, was an apportioned corporate income tax imposed on a U.S. corporation doing business in the taxing state as well as other states and countries. Container Corporation complained, as does NCR here, that the inclusion of its foreign source income in the taxable income base apportioned by the states violated the Foreign Commerce Clause under the reasoning of *Japan Line* because foreign countries had already taxed the same income on an unapportioned basis.[5]

The Court in *Container* recognized that "the tax imposed here, like the tax imposed in *Japan Line*, has resulted in actual double taxation." 463 U.S. at 187. However, where actual double taxation of **property** ended the inquiry and invalidated the tax in *Japan Line*, the Court in *Container* considered the double taxation of **income** "clearly distinguishable" from what it had struck down in *Japan Line*. The Court allowed the

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[5]There is no dispute here about the elements of the test required by the Commerce Clause and applied by the Court in *Japan Line* and *Container*. *See Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1, 8 (1986). As in *Container*, the dispute between NCR and New Mexico in this case involves only the Foreign Commerce Clause concerns, not the four interstate Commerce Clause questions enumerated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

state's "double taxation" of corporate income to stand. *Id.* at 187-197.[6]

In all relevant respects the instant case is indistinguishable from *Container*. First, this case involves a tax on NCR's income rather than a tax on property. *Container*, 463 U.S. at 188. *See also Mobil Oil* on this point: "[t]he reasons for allocation to a single situs that often apply in the case of property taxation carry little force" in the case of income taxation. 445 U.S. at 445.

Second, the circumstance causing the double taxation in *Container*—the interplay of two different taxation methods—are also present here, 463 U.S. at pp. 189-193. The Court in *Container* decided that under these circumstances double taxation of income is not dispositive, reasoning that resorting to one accounting method or another (arms-length/separate-accounting vs. world-wide unitary) would not eliminate all multiple taxation. *Id.* If double taxation of Container Corporation's income was permissible even though it could not be eliminated, then the fact that some[7] double taxation of NCR's income may occur in this case does not invalidate New Mexico's and all the other states' taxing systems. Moreover, it

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[6]In *Container* the Court also looked at the second prong of the *Japan Line* foreign commerce clause test and decided that, unlike the tax in *Japan Line*, California's corporate income tax did not prevent the Federal Government from speaking with one voice on foreign policy issues. NCR does not contest this prong of the test in its Petition.

[7]In fact, large amounts of NCR's foreign source income go untaxed every year. A comparison of the left hand columns of each of the tables set forth in Findings of Fact ¶¶ 29 and 30 (App. B at 29a-33a) reveals that in 1981, 37 percent of NCR's foreign source income was not taxed by any foreign country; in 1982: 52%; in 1983: 48%; in 1984: 50%; in 1985: 39%; in 1986: 43%; and in 1987: 27%.

is interesting to note that the federal tax returns of NCR show that it received a federal income tax credit that was greater than the taxes it paid to foreign governments.[8] Thus, as a practical matter, NCR has been paid back the taxes it paid to foreign countries and there is no double tax here at all.

The foreign and domestic taxing systems examined by the Court in *Container*—in which all of Container Corporation's income from its foreign subsidiaries was taxed by foreign governments and then an apportioned share of that very same income was taxed again by California—are similar to the taxing systems at issue in this case. NCR is simply wrong in arguing otherwise. Each foreign nation's allocation to itself of all of NCR's income earned in that nation for purposes of income taxation will always and necessarily overlap with every state's apportioned income tax system and result in the double taxation allowed by *Container*, whether the state taxes on the basis of worldwide combined accounting as used by California in *Container* or federal consolidated accounting as used by the United States and New Mexico here.

Third, as in *Container* but in contrast to *Japan Line*, New Mexico's tax falls on a corporation domiciled and headquartered in the United States and not on the foreign owners of an instrumentality of foreign commerce. *See Container*, 463 U.S. at 188. Here, New Mexico's tax is imposed on an apportioned part of the income of the United States parent company. New Mexico is not attempting to tax the foreign subsidiaries'

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[8] *Compare* the middle column with the two right hand columns in the table set forth in Findings of Fact ¶ 30 (App. B at 31a-33a).

income.[9] It is only when NCR is paid a dividend, royalty or interest by one of its foreign subsidiaries that those payments become part of NCR's base income, a part of which is apportioned by formula to New Mexico.

Finally, this case does not present discrimination of the kind recently struck down in *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, 112 S.Ct. 2365 (1992).[10] Indeed, in *Kraft* the Court explicitly approved taxation of foreign source income for corporations like NCR who file as a federal consolidated taxpayer. 112 S.Ct. at 2371, note 23. As the Court put it, under these circumstances "it would be difficult

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[9]For all the years in question, NCR Corporation elected to file its New Mexico corporate income tax returns on a federal consolidated basis; therefore, the taxpayer in this case is NCR Corporation, on its own behalf and on behalf of the other corporations included in its federal consolidated group. (Under Section 7-2A-8.4 NMSA 1978, corporations have the option of filing with New Mexico on a federal consolidated basis, if they also file their federal income tax returns on that basis.) Under federal law, most subsidiaries incorporated in foreign countries may not be reported in the federal consolidated group. 26 U.S.C. § 1504(b). In fact, none of NCR's approximately 75 foreign subsidiaries engaged in trade or business in the United States during the tax years in question (1981 through 1987); consequently, they were not included in NCR's federal and New Mexico returns and New Mexico is not attempting to tax the income of these foreign subsidiaries. Thus, New Mexico's power to tax that income is not at issue in this case.

[10]In *Kraft* the corporation reported its taxes to Iowa as a "separate corporate entity" whose domestic subsidiaries' income was **not** taxed by Iowa unless the subsidiary did business in Iowa. Thus, when Iowa taxed the dividends Kraft General Foods received from its foreign (non-U.S.) subsidiaries, but did not tax either the dividends it received from its domestic subsidiaries nor any of the income of those subsidiaries, the Court concluded that Iowa discriminated against the taxpayer in violation of the Foreign Commerce Clause.

to say that Iowa discriminates against the business with the foreign subsidiary." *Id.*[11]

II. THE COURT OF APPEALS CORRECTLY DECIDED THAT THE UNITED STATES CONSTITUTION DOES NOT REQUIRE THAT NCR BE GRANTED ANY FURTHER ADJUSTMENT OF ITS APPORTIONMENT FACTORS.

New Mexico applies the UDITPA three-factor apportionment formula to determine a taxpayer's presence in the state, a formula this Court has termed "a benchmark against which other apportionment formulas are judged." *Container*, 463 U.S. at 170. New Mexico applies this three factor formula to the income of NCR, which is the federal consolidated group, and **not** to the income of the foreign subsidiaries. Under UDITPA, business income from intangibles (including dividends, royalties and interest) is included in the sales factor of the taxpayer. Therefore, New Mexico already provides NCR with factor representation for its foreign source income by including this income in the denominator of the sales factor and excluding all of this income from the numerator. Section 7-4-18 NMSA 1978.[12] Under UDITPA, the property, payroll and

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[11]This is because the entire income of all of NCR's domestic subsidiaries was included in the apportioned base taxed by New Mexico, while only a portion of the income of the foreign subsidiaries—that paid to NCR—was included.

[12]NCR's argument that it is entitled to factor representation whenever it receives payments from its foreign subsidiaries proves too much, for it cannot logically be limited to foreign subsidiaries or foreign sources. NCR's proposal would require factor adjustment whenever business income is received from sources outside the consolidated group. Thus, the

sales of an entity are included in the apportionment factor only when the income of that entity is being taxed. Unlike Container Corporation which was subject to California's apportionment of the world-wide combined income of Container and all its subsidiaries, domestic and foreign, NCR is not entitled to any additional factor representation because New Mexico is not including in its apportionable base any of the income of the foreign subsidiaries.

Furthermore, NCR's request to include in its apportionment factors 100% of the property, payroll and sales of these foreign subsidiaries is totally unjustified. On average, less than 10% of the gross income of these companies is paid to NCR as dividends, interest and royalties, Findings of Fact ¶¶ 29 and 40 (App. B at 30a and 38a, respectively). Nowhere does NCR explain why they are entitled to dilute the states' apportioned share by including 100% of the foreign subsidiaries' factors when less than 10% of the income arguably produced by these factors was paid to NCR and therefore included in the apportionable base.

In *Container* the Court outlined two tests to aid in determining if an apportionment formula fairly taxes corporate income attributable to activity in the state. One test is the external consistency test, which asks whether the apportioned share of NCR's income being taxed by New Mexico is "out of all appropriate proportion" to the business done in the taxing state or leads to a "grossly distorted result." *Mobil Oil*, 445

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taxation of interest from NCR's overnight investments of working capital would presumably call for factor adjustment to include the factors of the payor bank. Taxation of royalty payments from the sale of NCR's optical scanning technology to a non-affiliated computer company would presumably call for the inclusion of the computer company's factors. But this is not how UDIPTA works.

U.S. at 436-437; *Container*, 463 U.S. at 170 and 180-181.

The Court has given considerable leeway to the states to apply this standard. On the one hand, this Court has invalidated an apportionment formula that resulted in a more than 250 percent difference between the taxpayer's reasonable alternative formula and the state's formula. *Hans Rees' Sons, Inc.*, 283 U.S. at 134. On the other hand, the Court allowed a state's apportionment formula to stand in the face of a 14 percent difference between the state's apportionment formula and a reasonable alternative because it decided that such a difference was "certainly within the margin of error inherent in any method of attributing income among the components of a unitary business." *Container*, 463 U.S. at 184.

The income attributed to New Mexico under the UDITPA formula is directly proportionate to NCR's intrastate values (indeed, that is precisely what the three-factor formula assures) and it is anything but a gross distortion of the taxable income produced using reasonably adjusted factors. *See Container*, 463 U.S. at 169-170. The difference between New Mexico's UDITPA formula apportionment and a reasonable version of NCR's alternative to the state's formula ranged between four and thirteen percent (seven percent overall), a difference that is well "within the substantial margin of error" permitted by the Supreme Court.[13] *Container*, 463 U.S. at 184. In fact, it

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[13]The modified formula used as a model by the hearing officer below (and affirmed by the Court of Appeals) to determine whether constitutionally significant distortion existed under the standard application of UDITPA added a percentage of the factors of the foreign subsidiaries equal to the percentage of their gross income actually paid to NCR. App.B at 60a-61a. (Note: the figures in the text above correct to NCR's favor a small error in the hearing officer's numbers.) *See, NCR (Maryland)*, 544 A.2d at 781; *Tambrands*, 595 A.2d at 1045.

appears that New Mexico has "slic[ed] a shadow" with a great deal of precision. *Container*, 463 U.S. at 192. *See also NCR (Minnesota)*, 438 N.W.2d at 93.

Significantly, two out of the three state courts which have recently determined the need for factor representation (and on which NCR relies in its Petition) based their decisions on the fact that the specific taxing schemes before them yielded tax liabilities which were out of all appropriate proportion to the companies' business contacts with the taxing states. *American Tel. & Tel. Co.*, 422 N.W.2d at 636; *Homart Dev. Co. v. Norberg*, 529 A.2d 115, 120-121 (R.I. 1987). Only *Tambrands* was decided (by a 2-1 majority) on the novel theory that factor representation is always required. New Mexico believes the well-reasoned dissent in *Tambrands* was correct.[14]

The second test outlined in *Container* is the internal consistency test, which asks whether the apportionment formula being challenged, if applied in all the states in which NCR's unitary business operates, would result in more than 100% of NCR's income being taxed. 463 U.S. at 169. Here, there is no dispute that New Mexico's apportionment formula mathematically cannot result in more than 100% of its income being taxed by the states.[15]

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[14]*See also NCR (South Carolina)*, 402 S.E.2d at 674, and *NCR (Maryland)*, 544 A.2d at 781-782, which decided there were insufficient facts in the record to rule on the apportionment challenge and remanded with instructions to the lower courts that they determine whether or not the state taxes resulted in gross distortion.

[15]The UDITPA apportionment formula requires the creation of three fractions: the value of a corporation's property in a given state (the property numerator) divided by its property everywhere (the property denominator), its payroll in that state (the payroll numerator) divided by

Nonetheless, NCR asks this Court to adopt a totally new constitutional requirement: that it be allowed factor representation as a matter of law, even if New Mexico's tax meets both the internal and external consistency tests set forth in *Container*. NCR gets to this point by seeking to have every jurisdiction in the entire world in which it does business included in the internal consistency test. This Court has never intimated that this result is required by the Constitution; nor is it logical for it to reach this result.

Neither this Court nor the Constitution can compel foreign countries to fairly apportion income among all taxing jurisdictions—can compel, that is, international internal consistency. The only way the Court could ensure that no multiple taxation would result from the combined effect of apportionment of income by states and allocation of income by foreign jurisdictions would be to allow foreign taxation to oust state authority to tax by prohibiting inclusion in the apportionable base of foreign source income entirely. This Court has already rejected that course in *Container* and *Mobil Oil*.

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its payroll everywhere (the payroll denominator), and its sales in that state (the sales numerator) divided by its sales everywhere (the sales denominator)—which are then added together and divided by three to arrive at the fraction of the corporation's total apportionable income which can be taxed by any given state. Sections 7-4-10 through 7-4-18 NMSA 1978. Mathematically, this formula ensures that the sum of all states' factors will never equal more than 100%.

CONCLUSION

For the reasons stated above, NCR's Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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Respondent.

On Petition for a Writ of Certiorari to the Court of Appeals of New Mexico

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

No. 93-541

NCR CORPORATION,

Petitioner,

v.

TAXATION AND REVENUE DEPARTMENT OF THE STATE OF NEW MEXICO,

Respondent.

On Petition for a Writ of Certiorari to the Court of Appeals of New Mexico

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PETITIONER'S REPLY BRIEF

Respondent does not dispute two of the three reasons advanced by NCR in support of its petition for certiorari: first, respondent concedes that the question of factor representation, which the Court left open in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), has created a conflict among state courts of last resort (Op. at 15); second, respondent nowhere denies that the questions presented by the petition are of great practical significance. Instead, respondent's opposition to the petition is predicated entirely upon its view that the decision below can be squared with this Court's precedents.

Respondent contends, as it has throughout this controversy, that NCR's Foreign Commerce Clause claim is controlled by *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983). Until now, however,

respondent has relied on *Container* for the proposition that multiple international taxation is constitutionally tolerable so long as it is not inevitable. From this premise, respondent has asserted, and the court below agreed, that respondent should prevail because, "in the instant case, . . . multiple taxation, although real, is not inevitable." Pet. App. A at 11a. While concurring with respondent's premise, NCR has steadfastly contended that New Mexico's taxing scheme does in fact subject it to inevitable multiple taxation. Accordingly, up to this juncture, the heart of the Foreign Commerce Clause controversy between NCR and respondent has been whether the multiple taxation at issue here was " 'inevitabl[e].' " *Container*, 463 U.S. at 188 (quoting *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 447 (1979)).

In its brief in opposition, however, respondent's reading of *Container* has taken a dramatic turn. Respondent no longer contests the key issue that had long divided the parties—whether this case involves "inevitable" multiple taxation. *See infra* p. 3 (quoting Opp. at 10). Rather, respondent now contends that *Container* sanctions the very inevitable multiple taxation of which NCR complains, namely, multiple taxation that occurs when "foreign countries ha[ve] already taxed . . . on an unapportioned basis" the "same income" that is included "in the taxable income base apportioned by the states." Opp. at 8. As we demonstrate below, however, respondent's reading of *Container* twists it beyond recognition and does not confront the essential question of inevitable multiple international taxation that NCR has asked this Court to review.

Respondent likewise ignores the crux of NCR's argument regarding factor representation. It does not even advert to the analysis set forth in Justice Stevens' dissent in *Mobil*, which addressed the factor representation issue the Court left open and which is squarely raised by this case. Instead, respondent is content to take refuge in the

defense that NCR has allegedly failed to demonstrate "gross distortion" (Opp. at 14), while neglecting the critical question whether the distortion inquiry is relevant to a theoretically defective formula like New Mexico's.

I. RESPONDENT'S FOREIGN COMMERCE CLAUSE DEFENSE OF NEW MEXICO'S TAXING SCHEME IS PREDICATED ON A PROFOUNDLY FLAWED READING OF *CONTAINER*

NCR's Foreign Commerce Clause argument is based on a simple syllogism: the Foreign Commerce Clause prevents a state from imposing a tax which inevitably causes international multiple taxation; New Mexico's taxing scheme inevitably causes international multiple taxation; New Mexico's taxing scheme therefore violates the Foreign Commerce Clause. Pet. at 10-15.

Respondent's brief in opposition takes no issue with the minor premise of this syllogism. Indeed, respondent explicitly recognizes that "[e]ach foreign nation's allocation to itself of all of NCR's income earned in that nation for purposes of income taxation will *always and necessarily* overlap with every state's apportioned income tax system . . . ." Opp. at 10 (emphasis supplied). Instead, respondent challenges the major premise of NCR's argument, contending that *Container* sanctions such multiple taxation and that *Container* is "indistinguishable" from this case "[i]n all relevant respects." *Id.* at 9. Specifically, respondent observes that both cases involve (1) an income tax, (2) double taxation caused by the "interplay of two different taxation methods," and (3) a domestic (rather than a foreign) taxpayer. *Id.* at 9-10.

Of these three similarities, only the second has any relevance to the Foreign Commerce Clause issue raised by NCR.[1] Moreover, with regard to the question of

[1] The two other similarities respondent has identified between this case and *Container*—that the tax is on income and that it

double taxation, respondent has failed to address, or even acknowledge, the most important distinction between this case and *Container*—a distinction with controlling constitutional significance. Unlike the double taxation in this case, the double taxation in *Container* was *not* the inevitable result of California's taxing scheme.

In *Container*, California sought to determine the state's taxable share of the income of a United States parent corporation—Container—that was engaged in a worldwide unitary business with its foreign subsidiaries. California determined its share of such income by combining Container's income with the income of its foreign subsidiaries and then apportioning a share of the combined income to California by a formula that included the

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falls on a domestic corporation—are beside the point. Earlier this year, the Court recognized in *Itel Containers Int'l Corp. v. Huddleston*, 113 S. Ct. 1095 (1993), that there were only "two distinguishing characteristics" (*id.* at 1103) between *Japan Line* and *Container* with constitutional significance: the inevitability of double taxation and the filing of an *amicus curiae* brief by the Executive Branch. Both of these elements were present in *Japan Line* but not in *Container*. *Id.* at 1103-04. We address the double taxation question in the text below. The filing of an *amicus* brief is relevant only to the question whether the tax impairs federal uniformity or prevents the Federal Government from "speak[ing] with one voice" (*Japan Line*, 441 U.S. at 449-50), an issue that NCR does not raise.

Wholly apart from *Itel*, the fact that *Container* involved a domestic corporation affected only the Court's deliberations regarding the "one voice" issue and has no bearing at all on the issue of international multiple taxation. Furthermore, the distinction the Court drew in *Container* between an income tax and a property tax is not a line between permissible and impermissible international multiple taxation. In *Container* itself, the Court recognized that "[i]f California's method of formula apportionment 'inevitably' led to double taxation . . . that might be reason enough to render it suspect." *Container*, 463 U.S. at 192-93. Moreover, the Court has observed that, in the context of income taxation, "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate." *Mobil*, 445 U.S. at 444.

property, payroll, and sales factors of the entire combined group. By contrast, the foreign countries in which the foreign subsidiaries were located employed an "arm's-length" approach to determining the subsidiaries' taxable income. Under this approach, each corporation is subject to taxation "only by the jurisdictions in which it operates and only for the income it realizes on its own books." *Container*, 463 U.S. at 184.

The Court in *Container* concluded that "the double taxation in this case, although real, is not the 'inevitabl[e]' result of the California taxing scheme." *Container*, 463 U.S. at 188. The Court carefully explained the distinction between taxing schemes which may at times permissibly cause "real" multiple taxation and those which will in all cases impermissibly cause "inevitable" multiple taxation:

> In *Japan Line*, we relied strongly on the fact that one taxing jurisdiction claimed the right to tax a given value in full, and another taxing jurisdiction claimed the right to tax the same entity in part—a combination resulting necessarily in double taxation. . . . Here, by contrast, we are faced with two distinct methods of allocating the income of a multinational enterprise. The "arm's-length" approach divides the pie on the basis of formal accounting principles. The formula apportionment method divides the same pie on the basis of a mathematical generalization. Whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case.

Id.

In short, the Court in *Container* did not sanction inevitable international multiple taxation. Instead it drew a sharp constitutional distinction between taxing schemes that necessarily produce international multiple taxation and those that adventitiously may give rise to such taxation. This crucial distinction has been entirely lost on

respondent, which has simply blurred the line between multiple taxes which are "real" and those which are "inevitable." [2] And respondent has therefore failed to recognize the constitutional significance of the distinction between the tax at issue here, which, it is now admitted (*see supra* p. 3), subjects NCR to inevitable multiple taxation, and the tax at issue in *Container*, which could as easily have led to undertaxation as to overtaxation. See *Container*, 463 U.S. at 188; Pet. at 13 n.7.[3]

For all of the reasons advanced by NCR here and in its petition for certiorari, the Foreign Commerce Clause issue warrants this Court's plenary consideration. Moreover, the Court's recent grants of certiorari in *Barclays Bank PLC v. Franchise Tax Board* (No. 92-1384) and *Colgate-Palmolive Co. v. Franchise Tax Board* (No. 92-1839) offer yet another reason for granting certiorari in this case. The Court's decision to consider these cases suggests that it is prepared to revisit at least one aspect of *Container*, namely, the "one voice" inquiry under the Foreign Commerce Clause. This case presents the other prong of Foreign Commerce Clause analysis—international multiple taxation. It will serve the interests of legal certainty and judicial economy for the Court to grant review here and, through this case, *Barclays*, and *Colgate*, to clarify *Container* and its relationship to the Court's Foreign Commerce Clause doctrine first articulated in *Japan Line*.[4]

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[2] "Blurred" may not be wholly accurate, since respondent never once even used the word "inevitable" in its brief in opposition.

[3] Multiple taxation is not inevitable when various jurisdictions divide the pie in different ways. It is clearly inevitable when, as here, one jurisdiction does not divide the pie at all.

[4] Respondent's assertion that the Court's decision in *Kraft General Foods, Inc. v. Iowa Dep't of Revenue and Finance*, 1112 S. Ct. 2365 (1992), "explicitly approved taxation of foreign source income for corporations like NCR who file as a federal consolidated taxpayer" (Opp. at 11) should not go unanswered. As respondent

II. RESPONDENT HAS OFFERED NO PRINCIPLED RESPONSE TO NCR'S CLAIM THAT THE FACTORS OF ITS UNITARY SUBSIDIARIES MUST BE REPRESENTED IN NCR'S APPORTIONMENT FORMULA

NCR contended in its petition that this case raises a question of great practical importance, which this Court left open in *Mobil* and which has subsequently divided state courts of last resort, namely, whether a state may include in a corporation's apportionable tax base income received from its unitary subsidiaries without taking account of the subsidiaries' income-producing factors in the apportionment formula.

In its brief in opposition, respondent grudgingly acknowledges the existence of the conflict (Opp. at 15),[5]

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itself concedes (Opp. at 11-12), *Kraft* involved only the issue of discrimination against foreign commerce, a question not raised in this case. Moreover, the only point contained in the footnote cited by respondent relates to the proper standard of comparison for determining whether such discrimination exists. *Kraft*, 112 S. Ct. at 2371 n.23. In any event, the footnote contains no reference to "corporations like NCR who file as a federal consolidated taxpayer." Opp. at 11.

[5] Of the three state court decisions that conflict with the decision of the court below, respondent explicitly acknowledges the conflict with *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991). Opp. at 15. It asserts, however, that the other two cases NCR cited as creating a conflict with the decision below, *American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue*, 143 Wis. 2d 533, 422 N.W.2d 629 (Ct. App. 1988), and *Homart Dev. Co. v. Norberg*, 529 A.2d 115 (R.I. 1987), were based "on the fact that the specific taxing schemes . . . yielded tax liabilities which were out of all appropriate proportion to the companies' business contacts with the taxing states." Opp. at 15. The suggestion that these two cases permitted factor representation because of a factual showing of distortion rather than as a matter of constitutional principle is false. The Wisconsin court in *AT&T* required a modification of the apportionment formula because "the apportionment formula used does not reflect a reasonable sense of how A.T. & T.'s income is generated" (*AT&T*, 143 Wis. 2d at 551, 422 N.W.2d at 636), not

but avoids the merits of the question that has given rise to it. Instead, respondent defends the decision below largely on the ground that New Mexico's apportionment of NCR's income, however defective from a theoretical standpoint, has not produced a "gross distortion." Opp. at 14. We have already noted that this good-enough-for-government-work defense is of questionable constitutionality in the context of an apportionment formula like New Mexico's which is flawed as a matter of principle. *See* Pet. at 19.[6] The other points that respondent raises in defense of its apportionment of NCR's income can be disposed of in short order.

Respondent claims that "New Mexico already provides NCR with factor representation" (Opp. at 12) by including the intangible income that NCR receives from its subsidiaries in NCR's sales factor. This defense fails because merely including the intangible income that NCR receives from its unitary foreign subsidiaries in NCR's sales factor—rather than including the factors of the subsidiaries themselves in NCR's factors—does not reflect how the income is generated. As the Court observed in *Container*, "the factor or factors used in the apportionment formula must actually reflect a reasonabe sense of how income is generated." *Container*, 463 U.S. at 169.

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because the application of the formula to the taxpayer produced a grossly distorted result. *See* Pet. at 16-17. Similarly, the Rhode Island court in *Homart* required a modification of the apportionment formula because "inclusion of this income in Homart's net income calculation *necessarily* requires that the payroll, property, and receipt factors that gave rise to it be included in the apportionment equation also." *Homart*, 529 A.2d at 121 (emphasis supplied).

[6] Even if the amount of distortion created by the lack of factor representation were relevant, it is greatly understated by respondent, because respondent determines NCR's factor representation by reference to the percentage of the subsidiaries' *gross* revenue paid to NCR. Opp. at 14 n.13; Pet. App. B at 59a. Since the factors are being employed to apportion *net* income, factor representation should likewise be determined by reference to the percentage of the subsidiaries' net income paid to NCR, which would substantially increase the factor representation to which NCR is entitled.

Respondent further contends that NCR's claim for factor representation should be rejected because "NCR's request to include in its apportionment factors 100% of the property, payroll and sales of these foreign subsidiaries is totally unjustified." Opp. at 13. In fact, NCR has never insisted that it was entitled, as a matter of constitutional law, to include 100 percent of the factors of its subsidiaries in its apportionment formula. NCR's position is and has always been simply that, if its "foreign source income is taxable by New Mexico and therefore apportionable, then . . . the United States Constitution [is] violated if the factors which gave rise to the income are not included in the apportionment factors." Stip. ¶ 26 (Pet. App. B at 28a).[7]

Finally, respondent asserts that NCR's claim that it is entitled to factor representation "cannot logically be limited to foreign subsidiaries or foreign sources" and "would require factor adjustment whenever business income is received from sources outside the consolidated group." Opp. at 12 n.12. The assertion is without merit. NCR's claim for factor representation is predicated on the fact that NCR and its foreign subsidiaries operate "a single, integrated, unitary business." Stip. ¶ 8 (Pet. App. B at 22a-23a). The stipulated facts thus present the quintessential case for factor representation. Whether factor representation is appropriate in other circumstances is a matter that the Court can leave for another day.

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[7] Insofar as portions of the stipulation included all of the subsidiaries' factors in NCR's apportionment formula, this merely reflected an agreement of the parties as to the disposition of the case should NCR or the respondent prevail. It did not reflect the parties' position on the factor representation that was required as a matter of federal constitutional law.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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